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Department of Defense

Report to Congress on the Indemnification of Contractors Performing Environmental Restoration

Office of the Deputy Under Secretary of Defense

(Environmental Security)

November 1993

OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON DC 20301-3000

ACQUISITION AND TECHNOLOGY

January 7, 1994

Honorable Sam Nunn
Chairman, Committee on Armed Services
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

I am pleased to provide this *Report to Congress on the Indemnification of Contractors Performing Environmental Restoration*. This document addresses the eight points of inquiry required by § 332 of the National Defense Authorization Act for Fiscal Year 1993, Pub. L. 102-484.

The report shows that, to date, the Department of Defense has generally received sufficient numbers of responses to environmental restoration solicitations and has successfully obtained qualified contractors even though we have not offered statutory indemnification provisions. Therefore, I am not requesting any additional indemnification authority at this time. We will continue to monitor the situation to ensure that the Department's environmental restoration work is performed efficiently and in a cost effective manner. The report does note that the available indemnification authorities may not cover all potentially important categories of environmental restoration contractors or contract circumstances.

A copy of this report has been sent to the Ranking Republican and the House Committee on Armed Services.

Very truly yours,

Sherri Wasserman Goodman
Deputy Under Secretary of Defense
(Environmental Security)

cc: Honorable Strom Thurmond
Ranking Republican

Executive Summary

This report on indemnification of contractors performing environmental restoration is provided to Congress by the Department of Defense (DoD) in response to § 332 of the National Defense Authorization Act for Fiscal Year 1993, Pub. L. 102-484. It was developed in consultation with the Department of Justice, the U.S. Environmental Protection Agency, the Office of Management and Budget, and other federal agencies. It is primarily based on information obtained from these government agencies, contractor trade associations, the insurance industry, and private parties performing environmental restoration.

DoD has access to three statutory indemnification authorities: Pub. L. 85-804, 10 U.S.C.A. § 2354, and Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) § 119. The use of these indemnification authorities may not provide protection for all types of environmental restoration contractors or contract situations. Many environmental restoration contractors performing work at sites other than National Priorities List sites may not be covered under the existing protection mechanisms. Chapter 2 provides more detailed information on these indemnification authorities.

The data from the DoD components indicate there has been no difficulty in obtaining qualified environmental restoration contractors without offering indemnification. In fact, the limited evidence to date from EPA and the state of New Jersey, both of whom routinely offered indemnification in the past but no longer do so, suggests that there is no noticeable effect on the level of competition resulting from a lack of indemnification. The DoD component data shows that both small and large firms, including several of the major environmental engineering firms, are bidding and winning environmental restoration contracts. Even so, it is still conceivable that there are segments of the contracting community that could provide even better services at a lower cost to DoD, but that decline to bid because of the lack of indemnification. Based on the data provided by the DoD components, it appears that very few large defense firms and only a limited number of large environmental companies have responded to DoD environmental restoration solicitations. Several large acquisitions currently under way may provide DoD an opportunity to better evaluate the issue of adequate competition, including whether there is, indeed, a relationship between indemnification and the level of competition. See Chapter 3 for more detailed information on the adequacy of competition for DoD's environmental restoration contracts.

Contractors that have performed the sorts of activities an environmental restoration contractor would perform, e.g., soil excavation and movement, have been found to be Potentially Responsible Parties (PRPs) as defined by CERCLA, and held liable for contribution to other PRPs. However, in only one case so far has an environmental restoration contractor actually been found liable for CERCLA cleanup costs. No contractor, either an "ordinary construction contractor" that has undertaken restoration-like activities that encountered hazardous waste or an actual environmental restoration contractor, has been found liable for claims for damages or personal injury resulting from a release from a hazardous waste site. However, there is nothing in the law that intrinsically diminishes the viability of these claims. Courts have refused to dismiss them in pending cases, and thus have cleared the way for litigation to proceed. See Chapter 4 for more detailed information on the liabilities and associated litigation faced by environmental restoration contractors.

Most federal agencies, including DoD, do not regularly offer statutory indemnification to environmental restoration contractors. State agencies have widely varying practices. Eight states have indemnified environmental restoration contractors under state authority in the past, although at least one state no longer offers this indemnification. Fourteen states provide contractors with immunity rather than indemnification; this means that an injured party may have no way to obtain compensation for damages. Private party indemnification practices are difficult to ascertain. DoD received information from 17 major PRPs. Although there are exceptions, this evidence suggests that most private parties provide, at most, only very narrow indemnification to their environmental restoration contractors. In addition, most of the PRPs require the contractor to indemnify them against liabilities that could arise from the contractor's negligent acts. See Chapter 5 for more detailed information on the indemnification practices of federal agencies, state agencies, and private parties. See Chapter 7 for more detailed information on past DoD indemnification practices.

Environmental impairment liability (EIL) insurance is becoming more widely available and at

somewhat more reasonable prices. This is particularly true for policies that can take advantage of bulk-rate pricing by covering several large contracts. It may be that the better terms and lower costs available on multi-contract policies are due more to the increased negotiating power than to the "economies of scale" that typically impact bulk-rate costs. EIL policies still do not cover the "long-tail" liabilities—those that occur decades after the policy is written and the premiums paid. This is particularly important in the context of environmental restoration because many of the health effects that may occur as a result of an environmental restoration are not expected to surface for 10 to 30 years. See Chapter 6 for more detailed information on EIL insurance availability, coverage, and rates.

This report does not recommend any additional indemnification authorities at this time. However, it does discuss possible costs and benefits of various indemnification policies. One important but often overlooked cost is the social cost associated with the policy of not providing indemnification to environmental restoration contractors. Who pays for the losses and injuries of citizens exposed to a release from a DoD site if the government is not required to compensate them and the contractor lacks insurance and the financial resources to do so? This situation is a very real possibility and in fact, exists on a smaller scale at the state-run cleanups that have provided immunity, rather than indemnification or insurance, for their environmental restoration contractors. See Chapter 8 for more detailed information on possible indemnification policy costs and benefits.

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Chapter 1: Introduction

This report on indemnification of contractors performing environmental restoration is provided to Congress in response to § 332 of the National Defense Authorization Act for Fiscal Year 1993, Pub. L. 102-484. It was developed in consultation with the Department of Justice, the U.S. Environmental Protection Agency, the Office of Management and Budget, and other federal agencies.[1] The report is based primarily on information obtained from the federal agencies, contractor trade associations, the insurance industry, and private parties performing environmental restoration. Additional information was obtained from congressional hearings, journal articles, and other publicly available sources.

ORGANIZATION OF THIS REPORT

This introduction presents an overview of the indemnification issues that pertain to this report. It also provides pointers to the chapter(s) in the report containing more detailed information on each issue. Lastly, it presents some basic terminology and definitions that are used in the remainder of the report.

The main body of the report is organized into chapters that correspond to the eight paragraphs in § 332. With one exception, each of these chapters contains the response to one paragraph. Because paragraphs (2) and (3) are closely related and have a common response, they were answered together in a single chapter. Thus, there are seven rather than eight chapters following this introduction.

Each of the seven chapters has a similar structure, composed of four distinct parts. Each chapter begins with a verbatim quotation of the paragraph from § 332 that the chapter addresses. Next, it presents a synopsis of the response to that paragraph, which can be used to gain insight into the response without reading all of the details. The remainder of the chapter text provides the detailed response to the subject paragraph. Notes for the responses to the paragraphs are found at the end of each chapter.

OVERVIEW OF THE INDEMNIFICATION ISSUE

Definitions of "Environmental Restoration Contractor" and "Indemnification"

Environmental restoration contractors, as used in this report, are defined as those contractors who are hired specifically to perform environmental restoration activities in connection with previously contaminated sites. Therefore, contractors that perform environmental restoration as part of another function, such as operating defense facilities, are not considered to be environmental restoration contractors, *per se*. Environmental restoration contractors perform many types of work: environmental studies, design, construction, transportation, storage, disposal, and management. Different categories of environmental restoration contractors may be exposed to different kinds of liabilities, and each may have different risk management options open to them.

The term environmental restoration contractor is broader than response action contractor (RAC), as defined in the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA).[2] RACs are those environmental restoration contractors that perform work at National Priorities List (NPL) sites or perform removal actions at any site. Most DoD environmental restoration is performed at non-NPL sites and includes work other than removal actions.

Indemnification is an agreement whereby one party (the United States) agrees to reimburse a second party (the environmental restoration contractor) for liability to third parties or enforcement agencies for damages or additional cleanup costs that result from the contractor's performance of work under contract to the government. It is therefore a contractual obligation that transfers some or all of the liability risk from one party to another.[3]

The extent of the risk transfer depends on the specific terms of the indemnification. Indemnification can be structured to transfer most of the environmental restoration contractor's liability risks to the government, including liabilities arising from the contractor's negligent acts. However, it can also be structured to provide much more limited coverage by including deductibles to be paid by the contractor, maximum amounts to be paid by the government, and restrictions on the types of liabilities covered.

Indemnification in Context

The issue of whether or not indemnification or the use other risk-sharing mechanisms is needed or appropriate requires analysis of a complex and interacting set of contractor and governmental

relationships, risk allocation goals, liability theories, public policy considerations, and specific indemnification mechanisms.

The question at the core of the DoD indemnification issue is: "Who pays for the losses and injuries caused by a release from a DoD site during environmental restoration?" Environmental restoration contractors are concerned that they will be liable for paying a disproportionately large share of this compensation, even though many actions may be beyond their control.[4] After all, they were hired to clean up the contamination; they had no part in creating it in the first place. The government, on the other hand, is interested in obtaining the best environmental restoration value possible. If the government absorbs some of the contractors' liabilities, then the incentive for quality performance may be diminished and potential future outlays faced by the government may increase. This may mean that the taxpayer will be further taxed to transfer the risk from a for-profit business to the general public.

Theories of Liability

There are various theories of liability under which claims may be asserted, and these theories apply in varying degrees to environmental restoration work. This discussion will focus on liabilities for which indemnification may be appropriate.[5] These fall into two main categories: (1) liability for CERCLA cleanup costs, and (2) liability for personal injury and property damage, called tort liability. Liability for CERCLA cleanup costs is generally controlled by federal law under CERCLA.[6] Liability for personal injury and property damage is generally controlled by state law, and therefore varies significantly from state to state.

CERCLA Cleanup Liability

CERCLA imposes strict liability for cleanup costs on all persons, including the federal government, falling into any of four categories. These categories are: (1) owner or operator of the facility; (2) former owner or operator at the time of disposal; (3) a person who arranged for disposal of hazardous substances at a facility, known as a generator; or (4) transporters who select the disposal facility, including the federal government. Strict liability is a doctrine that imposes liability without regard to fault. This means that contractors subject to strict liability could perform flawlessly, but if their action caused a release of hazardous waste or damage, the contractors are liable. Chapter 4 provides additional detail about CERCLA cleanup liabilities.

Most contributors of materials to a hazardous waste site have been held to be "jointly and severally" liable for cleanup costs. This means that the claimant can sue any of the contributors and recover the entire judgment from that single contributor. That contributor can then sue the other contributors to recover their shares of the judgment, but in the meantime, the claimant is paid. In general, courts hold defendants jointly and severally liable when the damage caused is difficult to divide among the defendants. Recent Appeals Court decisions put the automatic application of joint and several liability for CERCLA cleanup costs into question. Chapter 4 provides more detail on CERCLA cleanup liability.

Personal Injury and Property Damage Liability

States may impose either a strict liability or negligence standard for personal injury and property damage (tort) liabilities. Generally, if a state court finds that the activity is "ultrahazardous," then strict liability (liability without fault) applies. Courts have varied in their determination whether hazardous waste cleanup is considered an "ultrahazardous" activity. If the activity is determined not to be ultrahazardous, then the defendant must be found to be negligent in order to be liable for tort damages.

Negligence is defined as the failure to exercise due care. Professional negligence imposes a slightly higher standard, i.e., failure to comply with the generally accepted standards of the industry. Since the environmental restoration field continues to develop at a rapid rate, it is difficult to define professional standards of conduct. In the event of litigation, there is also a possibility that the "then-current" standards, rather than those in place when the activity occurred, could be imposed. Chapter 4 provides additional information on tort liabilities and how they may apply to environmental restoration contractors.

One of the major concerns of environmental restoration contractors is that the federal government may be immune from tort liability on actions for which both the contractor and the government bear direct responsibility. This may leave the contractor exposed as the only remaining target for such claims. If a judgment is assessed against the contractor and the contractor does

not have adequate insurance, or is otherwise unable to pay, the injured parties may go uncompensated. Chapter 4 discusses the federal government's immunity to certain tort claims. Chapter 8 addresses the social cost that results from injured parties who are unable to obtain compensation for their injuries.

"Long-Tail" Liabilities

Many of the aspects of liability found in environmental restoration contracting are similar in principle to those that are routinely addressed in contracts that deal with real property development or modification for the government. However, some significant differences have infused environmental restoration contracting with additional risks. Primary among these is the uncertainty of "long-tail" liabilities. Because health effects from hazardous material exposures during environmental restoration activities may not become apparent for years or even decades after the completion of the work, contractors are exposed to tort liability for an indefinite period of time. These long-tail liabilities are particularly significant because insurance may no longer be in force, and claims against the government may not be possible. Chapter 5 provides further information on the availability, coverage, and cost of environmental impairment liability insurance. Chapter 2 provides information on the coverage and timeframes of various indemnification authorities.

Indemnification Considerations

Indemnification can be examined from at least four perspectives: (1) the cost aspect, (2) the contractor performance aspect, (3) the fair contracting practice aspect, and (4) the social cost aspect. The cost aspect examines whether potential cost savings from indemnification (perhaps as a result of increased competition, increased use of innovative technology, or reduced insurance costs) outweigh the potential costs to the taxpayer for contractor indemnification. The answer is currently unknown. Contractors contend that the risk of performing environmental restoration work without indemnification is too great; they maintain that they, in effect, "bet the company" every time they bid. They warn that DoD soon will be unable to obtain adequate competition, and consequently that its environmental restoration costs will be higher than they need to be.

DoD has not yet experienced this lack of competition in terms of sufficient numbers of qualified bidders, so the contractors' concerns may simply be "worst-case fears". In fact, the limited evidence so far indicates that there is no noticeable relationship between indemnification and the amount of competition. At one time, EPA and the state of New Jersey both offered indemnification on a routine basis, but no longer do so. To date, neither have observed a change in competition. Chapter 3 provides further insights and information on the adequacy of competition for DoD environmental restoration contracts. Chapter 8 discusses the costs of various indemnification policies.

Indemnification may also affect contractor performance. If contractors are not financially responsible for the consequences of their actions, they lose an important incentive for performing in a responsible manner. Less prudent contractors may then perform environmental restoration carelessly, exposing the government to greater liabilities than the contractor would have been exposed to if no indemnification were offered. In addition, this careless attitude could adversely affect the quality of the environmental restoration work itself.

Both the cost aspect and the contractor performance aspect clearly point out the need to address the extent of the coverage provided by any indemnification policy under consideration. Unlimited indemnification is like writing a blank check that may be presented to the government and the taxpayer at some future time. In this case, the claim costs would probably greatly outweigh any cost savings resulting from indemnification. However, as discussed above, indemnification terms can be structured to limit the potential outlay that the government faces. Furthermore, by including deductibles and limits on the types of covered liabilities, the indemnification terms can also provide some continued financial incentive for contractors to perform responsibly.

The fair contracting practice aspect addresses the question of whether or not it is equitable for environmental restoration contractors to be exposed for years to liabilities sometimes resulting from situations they did not create and over which they had little control. If not, should the government assume this liability through indemnification or other risk-sharing mechanisms?

The social cost aspect occurs when parties injured because of environmental restoration of DoD sites do not have a way to obtain compensation for their injuries. In terms of public policy, should the govern-

ment provide compensation to these parties? In addition to the brief discussion above, this issue is discussed in more detail in Chapter 8.

Indemnification Policies

Indemnification of environmental restoration contractors is the exception in both public and private sectors. Most federal agencies do not routinely provide indemnification. A few states provide indemnification for their environmental restoration contractors, but even more provide immunity. This means that the contractor is protected and the state does not incur additional liabilities. It also means that injured parties do not have a way of obtaining compensation for their injuries. Limited information suggests that most private parties who engage in environmental restoration contracting do not offer broad indemnification protection, although some provide very narrowly defined coverage. Chapter 5 provides more details on the indemnification practices of federal agencies, state agencies, and private parties. Chapter 7 provides details about DoD's use of the indemnification authorities.

ENDNOTES:

[1]Pub. L. 102-484 § 332 requires that this report be prepared "in consultation with the Attorney General, the Administrator of the Environmental Protection Agency and the Director of the Office of Management and Budget." Copies of these agencies' comments are contained in Appendix 3.

[2]Comprehensive Environmental Response, Compensation, and Liability Act, as amended by the Superfund Amendments and Reauthorization Act of 1986 (Superfund) 42 U.S.C.A. § 9601-9671 (West 1983 & Supp. 1993).

[3]Indemnification can be provided as (1) "indemnification against liability or loss," which provides a contractor with the right to recover from the United States the amount of that liability or loss, or (2) "to hold harmless," which means that the United States assumes all expenses incident to the defense of any claim, in addition to fully compensating the contractor for all loss or expense.

[4]Tunnicliffe, Peter, Hazardous Waste Action Coalition. Letter to Patrick Meehan, re: Indemnification of DoD Environmental Response Contractors, 1 February 1993 (*see* Appendix 6).

[5]Other liabilities would include first-party liability (liability to the party with whom the entity is contracted) and liabilities to Government entities for administrative and criminal penalties and fines. First-party liabilities are generally based on breach of contract claims for which indemnification, in the sense used here, does not apply.

[6]However, there are state statutes patterned after CERCLA that may impose cleanup liabilities on the environmental restoration contractor.

Chapter 2: Indemnification Authorities

Response to § 332, Paragraph (1)

Paragraph (1): All existing statutory authorities and regulations thereunder available to the Department of Defense that allow the Secretary of Defense or the Secretaries of the military departments to indemnify and hold harmless contractors performing environmental restoration at current military installations, former military installations, and formerly used defense sites pursuant to the Defense Environmental Restoration Program under chapter 160 of title 10, United States Code.

SYNOPSIS

Indemnification authorities presently available to DoD cover some of the types of environmental restoration work that DoD acquires by contract with private firms. Pub. L. 85-804 is discretionary and can be applied to cover losses that result from unusually hazardous or nuclear risks whenever the approving authority finds that such action would facilitate the national defense. 10 U.S.C.A. § 2354 applies only to research and development contracts. CERCLA § 119(c) covers only RACs,[1] which are a certain type of environmental restoration contractor working at NPL sites or performing removal actions. Some environmental restoration work—such as field sampling, analysis, and site characterization—can fall outside clearly established areas of application of these authorities. Other environmental restoration activities may not be covered if the work is in support of non-NPL installations, which comprise the overwhelming majority of DoD's sites.

Indemnification afforded under Pub. L. 85-804 is discretionary, and could be applied to any environmental restoration contract where the cleanup circumstances are found by the approval authority to meet the criteria for its employment. Its application requires preparation of a Memorandum of Decision executed by the agency head, which may pose a practical administrative limitation to its widespread use for environmental restoration contracts.

OVERVIEW OF INDEMNIFICATION AUTHORITIES

DoD has access to three statutory indemnification authorities to provide contractors with protection from liabilities resulting from environmental contracts. In general, the contractor's potential liabilities fall into two classes: (1) costs of cleanup and (2) costs of injury or damages to "third parties," that is, someone other than the government and the contractor.

The statutory indemnification authorities that could be used, when circumstances permit, to indemnify contractors performing environmental restoration work at DoD installations and sites are referred to in this document as Public Law 85-804[2] (National Defense Contracts Act), 10 U.S.C.A. § 2354[3] (Contracts—Indemnification Provisions) and CERCLA § 119(c).[4] Each of these authorities can be used to provide indemnification to government contractors under different conditions and are available under specific circumstances.

INDEMNIFICATION

For the purposes of this report, "indemnification" is defined as an agreement whereby one party (The United States) agrees to reimburse a second party (environmental restoration contractors) for costs incurred by the second party to pay for cleaning up contamination on a third-party property or for damages or injuries to a third party. Indemnification is an express contractual[5] obligation of the United States that allocates the risk of third-party liabilities and potential cleanup cost liabilities between the contracting parties—the government and the environmental restoration contractor.[6] Indemnification is designed to compensate specific loss or damage incurred by a contractor performing work under a contract with the United States.[7] Indemnification is based on a specific statutory authority and covers specifically defined risks. It is typically not subject to a funding limitation, and remains effective after contract completion.

Indemnification typically takes the form of a special clause inserted into the contract that identifies the covered risks being indemnified. Indemnification clauses require the United States to make a payment to the contractor or some other party if a covered event occurs.[8] If a covered event does not occur, no actual liability of the United States would ever arise under the indemnification clause. However, because indemnification clauses require the United States to pay if a covered event occurs, indemnification clauses are referred to as "contingent liabilities" of the United States.[9] Contingent liabilities of the United States have both legal and budgetary implications.

Chapter 2: Indemnification Authorities

The legal implications are introduced by the Anti-Deficiency Act,[10] which prohibits the making of obligations or expenditures that exceed available appropriations. As a general rule, unlimited contingent liabilities are deemed to violate the Anti-Deficiency Act since it is never possible to have adequate funds available to pay for a potentially unlimited liability.[11] Therefore, indemnification clauses must be either (1) based on a specific statutory authority that is excepted from the Anti-Deficiency Act,[12] or (2) must limit the amount of the liability of the United States in order to comply with the Anti-Deficiency Act.[13] Since environmental contractors seek some protection from unknown future liabilities, indemnification could obligate the government to pay an unknown future sum without an appropriation for that amount.

The budgetary implications of indemnification could be significant. When DoD indemnifies a contractor, the government assumes a financial risk that would otherwise fall on the contractor. This assumption of risk increases the likelihood that additional government financial outlays will be required in the future. These potential additional outlays are counted among the government's contingent liabilities. In 1989, contingent liabilities of the United States amounted to over $4 trillion.[14] Since government resources are obviously limited, prudent financial management dictates that indemnification should be used only when necessary.[15]

SPECIFIC INDEMNIFICATION AUTHORITIES

Pub. L. 85-804, "The National Defense Contracts Act"

Pub. L. 85-804 permits certain government agencies that exercise functions in connection with the national defense to make or modify contracts whenever the President deems such action would "facilitate the national defense."[16] The most frequent use of this authority has been to authorize contingent liabilities.

Pub. L. 85-804 provides for extraordinary relief of contractors and permits the broadest contractual indemnification available under federal law. If applied, it could largely eliminate the risks faced by DoD's environmental contractors. This authority is exempt from the Anti-Deficiency Act and thus not subject to limitations of appropriated funds. This statutory authority is implemented by Executive Order 10789,[17] which permits a dozen federal agencies the authority to indemnify their contractors.[18] Each application of this authority is a special case, and must be supported in a Memorandum of Decision executed by the agency head. However, its general applicability to DoD environmental restoration contracts is a matter of some disagreement since the work undertaken in these contracts may not generally meet the criteria for using Pub. L. 85-804.

Regulatory Provisions

Regulatory implementation is found in FAR Subpart 50.4, "Residual Powers," with a prescribed contract clause at FAR 52.250-1.

Scope of Coverage

The contractual indemnification provided by Pub. L. 85-804 is very broad and applies to any losses not compensated by insurance, including reasonable expenses of litigation and settlement, third-party claims for injury or damage, loss or damage to the property of the contractor, loss or damage to the property of the government, and claims arising from indemnification agreements between the contractor and its subcontractors. The implementing FAR clause, FAR 52.250-1, does not directly address contractor pollution liability, which in some instances might be more extensive than the "loss, damage, or lost use of property" covered in the clauses. It is not clear if claims asserted by regulatory entities for environmental cleanup costs would be considered third-party claims. It would cover claims based on strict liability (that is, liability without fault), as well as those arising from contractor negligence. The agency may tailor the application of this authority to the specific circumstances of an environmental restoration contracting situation. Indemnification under the Pub. L. 85-804 may be extended to subcontractors with contracting officer approval.

Pub. L. 85-804 has not been used to indemnify DoD contractors performing on environmental restoration contracts. A provision that would specifically enable use of Pub. L. 85-804 for environmental restoration activities at current and former military installations and facilities that was included in the FY 93 Defense Authorization bill prompted a critical response from some members of Congress[19,20] and was not passed.

Exclusion

The protection afforded under Pub. L. 85-804 does not cover willful misconduct or lack of good faith on the part of the contractor's principal officials including directors, officers, managers, superintendents, or other

representatives supervising or directing (1) substantially all of the contractor's business, (2) substantially all of the contractors' operations at any one plant or separate location where this contract is being performed, or (3) a separate and complete major industrial operation connected with the performance of this contract.[21]

Anti-Deficiency Act

Indemnification under Pub. L. 85-804 is not limited by available appropriations and is thus exempt from the Anti-Deficiency Act.

Timeframe

Indemnification under Pub. L. 85-804 is not limited in time.

Qualifications

Pub. L. 85-804 indemnification must be approved in advance by an official at the level of secretary of a military department. For the activity to qualify under this authority, it must meet the following three qualifications that are documented as findings in a "Memorandum of Decision".[22]

(1) Unusually hazardous or nuclear in nature. The activity for which indemnification is to be provided must be unusually hazardous or nuclear in nature. The FAR does not define "unusually hazardous" risks in connection with using Pub. L. 85-804, but leaves the identification of these risks to be specified in the contract and approved by the approval authority.

In environmental restoration contracting, the risk circumstances related to response actions taken by the contractor can differ markedly in different instances. Some environmental restoration actions could involve recovering large amounts of highly toxic substances found in dump sites. Other situations could be described as "unusually hazardous" only because small but measurable quantities of listed wastes (substances identified as hazardous in the EPA's "Hazardous Waste Management System"[23]) are involved in the cleanup. Most of DoD's contamination results from chemical residues that are not dissimilar to those routinely addressed in the commercial sector. While the substances may be listed as hazardous, they may not be unusually so.

The restatement of Torts (2nd) provides a widely recognized framework for determining whether an activity is abnormally dangerous. Section 520 lists six factors to weigh when determining whether a given action is an ultrahazardous activity:

- Existence of a high degree of risk of some harm to the person, land, or chattel of others
- Likelihood that the harm resulting from the activity will be great
- Inability to eliminate the risk by the exercise of reasonable care
- Extent to which the activity is not a matter of common usage
- Inappropriateness of the activity to the place where it is carried on
- Extent to which its value to the community is outweighed by its dangerous attributes

These factors are not legally applicable to a DoD decision that an activity is "unusually hazardous," but they provide a benchmark for consideration.

Finally, another approach to "unusually hazardous" could be whether a risk is insurable. To the extent that commercial insurance is unavailable for a risk under a government contract, then that risk may be considered unusual. This approach could also provide the basis for a policy decision by a secretary that the government should assume the risk involved.[24,25]

(2) Insurance. In determining the appropriateness of Pub. L. 85-804 indemnification, the Secretary, must take into account the availability, cost, and terms of private insurance, self-insurance, and other proof of financial responsibility.

(3) Facilitate the National Defense. Perhaps the most difficult finding for the Memorandum of Decision is the assertion that the use of Pub. L. 85-804 facilitates the national defense for environmental restoration contracts. In general, where the only nexus between cleanup and the national defense is that the contamination was caused by a defense-related activity or occurs at a defense-related facility, a recent Congressional Research Service document offers the opinion that the argument is weak for extending the

coverage of Pub. L. 85-804 to environmental restoration contractors.[26] However, if a cleanup has some arguable linkage to facilitating the national defense (e.g., cleanup activities that appear reasonably related to ongoing military operations and defense readiness, and actions necessary to support them), Pub. L. 85-804 likely does allow indemnification of cleanup contractors.[27]

Thus, Pub. L. 85-804 may be applicable to cleanups required to maintain the operating capability of a military base that has not been selected for closing, but application to closing bases and formerly used defense sites (FUDS) is questionable since the connection with "facilitating the national defense" may be less evident. In early 1993, the Army considered applying the authority to a cleanup situation at a FUDS site. While the contractor involved was not technically an environmental restoration contractor, it did perform some activities typical of such a contractor. The army did not utilize Pub. L. 85-804 because of the uncertainties regarding its applicability and the administrative requirements for its approval.[28] Conversely, if indemnification of cleanup contractors at closing bases or FUDS is determined to facilitate the national defense by accelerating cleanup and hastening the redirection of defense resources to other essential defense needs, Pub. L. 85-804 would permit it.

The uncertainty about the specific application of this authority to environmental restoration contractors notwithstanding, the use of Pub. L. 85-804 is discretionary. A frequently referenced principle is "any action or decision by an agency under Pub. L. 85-804 is within the exclusive discretion of the executive branch of the government and is not subject to judicial review."[29] Therefore, a decision to indemnify cannot be reversed in court; neither can it be compelled.

In that sense, legal issues about the applicability of Pub. L. 85-804 are moot. DoD could broadly apply it to environmental remediation contracts without legal challenge. However, key members of Congress have challenged the propriety of its use for that purpose, and a Senate amendment that would have specifically applied it to environmental restoration contracting did not pass. As a result of this opposition, policy makers may be inhibited from using Pub. L. 85-804 for this purpose even though it cannot be legally challenged.

Administrative Requirements

As discussed above, when approving a proposal for the exercise of Pub. L. 85-804 indemnification, the approving authority must prepare a Memorandum of Decision justifying its use.

The process for approving the use of Pub. L. 85-804 authority can be somewhat protracted and cumbersome. It is normally used in connection with requests for indemnification related to large contracts that may span significant timeframes and involve serious technological difficulties. The process is not well-suited for dealing with the multitude of relatively small contract actions that are dealt with under the Defense Environmental Restoration Program (DERP). FAR Part 50.403 outlines the information that must be supplied by the contractors, especially representations of financial responsibility. FAR Part 50.403-2 describes the steps that the contracting officer must pursue to act on indemnification requests. This approval process must be negotiated for each individual contract under which this authority is to be used unless some blanket authority is separately established for a class or kind of contract. Additionally, the agencies must report to Congress on their use of Pub. L. 85-804 authority.[30] These requirements are extensive and time-consuming and might also be sufficient to discourage the general use of the authority.

10 U.S.C.A. § 2354, "Contracts-Indemnification Provisions"

Regulatory Provisions

Regulatory implementation of this authority is found at DoD FAR Supplement (DFARS) 235.070, and the prescribed clauses are found at DFARS 252.235-7000 for fixed-price contracts and DFARS 252.235-7001 for cost-reimbursement contracts.

Scope of Coverage

10 U.S.C.A. § 2354 provides for indemnification under DoD Research and Development contracts or contracts that contain research and development components. Most environmental work for DoD is not likely to be accomplished through research and development contracts, but this authority would be available for work that might be acquired in such a way. For example, this might include testing innovative environmental cleanup technologies. Then, if indem-

nification is needed, § 2354 authority might be appropriate for such work.

Both DoD and EPA expect that innovative technology will accelerate the cleanup program, improve pollution prevention efforts, and save money over the long run. Both agencies support a research and development program aimed at delivering innovative cleanup techniques to the field as soon as possible.[31,32] DoD's Strategic Environmental Research and Development Program is designed to facilitate the introduction of new environmental technology into the DoD's operations and cleanup actions. EPA's SITE (Superfund Innovative Technology Evaluation) program is funded by various sources and engages in cooperative agreements with federal installations to test its technology.

Indemnification may extend to third-party claims,[33] contractor property loss or damage, and government property loss or damage arising out of risks defined in the contract as unusually hazardous.[34] However, some courts might rule, as they have in the context of CERCLA, that cleanup costs are not property damages.[35] Indemnification under § 2354 may be extended to subcontractors,[36] and could include claims or losses based on strict liability. Contracts involving both research and development and other work may provide for indemnification under the authority of both § 2354 and Pub. L. 85-804. Pub. L. 85-804 would apply only to work to which § 2354 does not apply.[37] Indemnification authority may flow down to lower tiers of subcontractors upon the contracting office's prior approval.

Exclusions

Claims must not be compensated by insurance.

Loss or damage must not result from willful misconduct or lack of good faith on the part of any of the contractor's directors, officers, managers, superintendents or other equivalent representatives who have supervision or direction of (1) substantially all of the contractor's business, (2) substantially all of the contractor's operations at any one plant or separate location where this contract is being performed, or (3) a separate and complete major industrial operation connected with the performance of this contract.

Claims must not be for a liability assumed under any other contract or agreement unless approved by the contracting officer.

Anti-Deficiency Act

This form of indemnification is not exempted from the Anti-Deficiency Act. Upon approval of the secretary of the affected military department, payments may be made from funds obligated for the performance of the contract concerned, funds available for research or development, or both, and not otherwise obligated, or funds appropriated for those payments.[38] Funds available for research and development for military departments total in the billions of dollars annually, some of which could be reprogrammed to meet indemnification obligations under this authority.

Timeframe

The rights and obligations of the parties under the clause shall survive the termination, expiration, or completion of the contract.[39]

Qualifications

This authority is limited to contracts for DoD research and development. Loss or damages to the contractor's property is covered to the extent that the liability, loss, or damage results from a risk that the contract defines as unusually hazardous.[40]

Administrative Requirements

The specific unusually hazardous risks to be indemnified must be defined and submitted for approval with the request for authorization to grant indemnification during the contract formation process. Once a claim has been filed, it must be certified as just and reasonable by the secretary of the department or a designated representative.

CERCLA §119(c)

Regulatory Provisions

On 25 January 1993, EPA issued regulations in the Federal Register, vol. 58, No. 14 that implemented CERCLA § 119(c). Other federal agencies offering indemnification under this authority must not be inconsistent with EPA's guidelines.[41] These somewhat restrictive guidelines replace earlier interim guidelines under which EPA entered into over 1,000 indemnification agreements with Superfund contractors (RACs).[42]

Chapter 2: Indemnification Authorities

Scope of Coverage

CERCLA § 119 has two key provisions related to RACs: § 119(a) excludes RACs from liability under CERCLA or any other federal law for injuries, costs, damage, expenses, or other liability related to releases or threats of release stemming from non-negligent actions taken by the RAC in a response action, while § 119(c) provides for discretionary indemnification against liability arising from negligence for which insurance is not otherwise available.

CERCLA § 119(a) provides that, with respect to releases of hazardous substances, pollutants, or contaminants, RACs that are not negligent are exempt from liability under CERCLA or any federal law to any person for injuries, costs, damages, expenses, or other liability (including contribution) that result from such a release. Thus, RACs are protected from strict liability under CERCLA, Resource Conservation and Recovery Act (RCRA), and other federal laws,[43] but not under state laws. This protection exists so long as the release was not caused by the contractor's negligence, gross negligence, or intentional misconduct.[44]

CERCLA § 119(c) provides discretionary authority to offer indemnification to RACs against claims based on negligence under both federal and state law. Where indemnification is authorized under CERCLA § 119(c), RACs may be covered for their negligence in performing response actions; however, no coverage is afforded for instances where third-party claims liability arises from the application of strict liability, gross negligence, intentional misconduct or other theories of liability. This level of indemnification is permissible only if the RAC is unable to obtain adequate insurance at a fair and reasonable price.[45] Indemnification agreements under § 119(c) must include deductibles (amounts to be paid by the contractors), and must also limit the amount of indemnification.[46] Claims payments under the indemnification authority are subject to cost recovery.

The term "RAC"[47] in § 119(c) refers to a specific set of contractors who carry out remedial actions[48] at NPL sites, conduct removal actions, or provide evaluation, planning, engineering, surveying and mapping, design, construction, equipment, or any ancillary services for NPL sites or removal actions. This is a subset of the group, "environmental restoration contractors," as identified in the introduction of this report.[49] The functions of an "environmental restoration contractor" as identified in § 332, correspond with those of a RAC, except that RACs are associated only with NPL facilities when performing remedial actions, or are carrying out removal actions.

CERCLA § 119(c)[50] provides DoD with limited discretionary authority[51] to indemnify RACs. Because most DoD facilities requiring remedial action are not on the NPL, § 119(c) indemnification authority is not available for most DoD remedial action contracts. Regarding removal actions, EPA has interpreted the language of CERCLA § 119(c) to extend indemnification authority to contractors performing removal actions at any site, regardless of NPL status. EPA has indemnified ARCS (Alternative Remedial Contracting Strategies) contractors performing at non-NPL sites under this interpretation.

Of DoD's 1,800 installations to which DERP applies, 101 are on the NPL.[52] Since most installations have more than a single site, and the NPL installations have more actual sites than the average installation, sites located on DoD's NPL installations comprise about 22 percent of DoD's total sites requiring remediation. Also, since the Hazard Ranking System[53] was applied to all DoD installations, only the most contaminated installations achieved a sufficiently high score to warrant listing on the NPL. Therefore, the installations where § 119(c) authority does apply, i.e., the NPL installations, are likely to be the worst cases. About 78 percent of the DoD sites, however, are non-NPL sites and § 119(c) does not apply to contractors working on remedial action at these sites.

The General Accounting Office (GAO) asserts that CERCLA § 119(c) should be used by authorized federal agencies to indemnify contractors, rather than the agencies' general contracting authority.[54] See Chapter 5 for a discussion on federal agency indemnification practices.

Exclusion

RACs may not be indemnified for their gross negligence or intentional misconduct, nor to state law claims based on strict liability.[55] The indemnification authority of CERCLA § 119(c) does not extend to the activities of RACs performed under RCRA programs.

Other significant limitations are found in EPA's 25 January 1993 final guidelines on Superfund Response Action Contractor Indemnification.[56] The guidelines state that EPA does not intend to offer indemnification agreements in its future solicitations

unless a solicitation does not produce adequate competition because of the absence of indemnification.[57] In the event that this should occur, a new or amended solicitation may be issued with indemnification coverage.[58] EPA has also established indemnification limits and deductibles that are linked on a sliding scale, with the maximum limit for most contractors set at $50 million.[59]

DoD may use this authority in its contracts, but the indemnification agreement must not be inconsistent with EPA guidelines. EPA's analysis states that agreements established by other agencies may contain numerical values that differ from those in its guidelines and that those differences would not necessarily make those agreements inconsistent with the guidelines.[60] Therefore, some flexibility exists to tailor the agreement to suit DoD's circumstances within the guidance.

Anti-Deficiency Act

Indemnification under § 119(c) is not subject to the Anti-Deficiency Act. However, amounts expended pursuant to § 119(c) for indemnification of any RAC shall be considered government response costs and those agencies using § 119(c) indemnification must use their own appropriations to pay indemnification costs.[61]

Timeframe

The term of coverage under EPA guidelines is limited to the period of contract performance plus ten years.[62] This could be changed if DoD uses CERCLA § 119(c) indemnification to fit DoD's requirements.

Qualifications

Under § 119(c), DoD may indemnify only environmental restoration contractors performing remedial actions at DoD facilities listed on the NPL, removal actions at any site, and other related work at such sites. EPA's analysis states "...the statute provides no authority for the indemnification of contractors under CERCLA § 119(c) performing remedial actions at sites that are not on the National Priorities List."[63]

Administrative Requirements

Before indemnification can be provided, EPA's guidelines require that the unavailability of contractors willing to work without indemnification must be demonstrated.[64] While DoD may use § 119(c), if needed, in a way not inconsistent with the EPA's guidelines, it is uncertain that a lack of adequate competition must be demonstrated in exactly the manner that EPA regulations require before § 119(c) can be applied by DoD. Withdrawing an initial solicitation when response is meager and then reissuing it with an indemnification provision will lengthen the procurement process further.

SUMMARY OF AUTHORITIES

Table 2-1 summarizes the primary attributes of the authorities available to DoD to indemnify environmental restoration contractors.

Pub. L. 85-804 provides DoD with broad, discretionary authority to indemnify contractors performing unusually hazardous activities if indemnification would facilitate the national defense. Although this authority has been used sparingly in other hazardous defense-related situations, it is available for use, to a limited practical extent, on environmental restoration contracts if the need arises. While the use of the authority is discretionary, the criteria for its application are specific and may be difficult to meet in many instances of DoD environmental restoration contracts. It may also be difficult to rationalize its applicability to cleanup of closing bases since their future use will be for civilian purposes rather than actually in the "national defense." Procedural complexity and a tradition of sparing use may serve to limit the authority's practical applicability to the increasing number of environmental restoration contracts and the expanding scope of the work that is being accomplished. Application of Pub. L. 85-804 is discretionary and not subject to judicial review. However, Congress reviews its use, and key members of Congress have expressed substantial opposition to employing it to indemnify environmental restoration contractors.

§ 2354 is powerful but very limited in its application since it applies only to research and development work.

CERCLA § 119(c) is available to indemnify RACs performing remedial action on NPL sites. Indemnification for RACs performing removal actions under CERCLA § 119(c) has been interpreted as being available at any site. The statutory definition of "RACs" is less encompassing than that of "environmental restoration contractor" as called for in § 332. Indemnification for contractors performing remedial actions under

Table 2-1. Summary of Indemnification Authorities

Authority	Codification	Exempt from Anti-Deficiency Act	Citation	Conditions	Timeframe	Covers	Does Not Cover
P.L. 85-804 "National Defense Contracts Act"	50 USC 1431	Yes	FAR 50.4 Residual Powers FAR 52.250-1	• Finding that indemnification would facilitate national defense • Risks the contract defines as "unusually hazardous" or nuclear • Consider available costs and terms of private insurance	Not limited in time	• Third-party claims for death, injury, loss, or damage • Government claims for loss or damage • Contractor claims for loss or damage • Strict liability • Contractor negligence • Lower tiers	• Willful misconduct or lack of good faith of the principals
	10 USCA 2354 "Contracts-Indemnification Provisions"	No	DFARS 235.070 DFARS 252.235.7000 DFARS 252.2351.7001	• Contract must be for Research and/or Development • Risks defined in the contract as "unusually hazardous"	Not limited in time	• Third-party claims • Government claims for loss or damage • Contractor claims for loss or damage • Strict liability • Contractor negligence • Lower tiers	• Claims covered by insurance • Willful misconduct or lack of good faith of the principals
CERCLA §119 (c)	42 USC 9619	Yes	58 Fed Reg 5972	• Response Action Contractor • Performing RA at DOD facilities on the NPL, or removals • Unable to obtain insurance at a fair and reasonable price	10 years past end of contract	• RACS performing remedial action on NPL sites, removal actions at any site, and related work on such sites - Third-party claims based on negligence	• Gross negligence • Intentional misconduct • Non-NPL sites, except removal actions • State strict liability

CERCLA § 119(c) applies at the less than 6 percent of DoD installations listed on the NPL. Since NPL installations are the most extensively contaminated and have more actual sites than the average installation, the sites on DoD's NPL installations comprise about 22 percent of DoD's total sites requiring remediation. Also, theHazard Ranking System[65] was applied to all DoD installations, and only the worst installations achieved a sufficiently high score to be listed on the NPL. Thus, the installations where this authority does apply for remedial actions are likely to be the worst cases. Nonetheless, a significant majority of DoD sites do not meet the criteria for use of CERCLA § 119(c) indemnification in the case of remedial actions and related work at such sites. Additionally, EPA's guidelines (e.g., the multiple solicitation requirement) impose administrative obstacles to the efficient implementation of its use in DoD.

ENDNOTES:

[1]The term "response action contractor" refers to any person who enters into a response action contract with respect to any release or threatened release of a hazardous substance, pollutant, or contaminant from a facility and is carrying out such a contract; person, public, or non-profit private entity, conducting a field demonstration pursuant to § 9660(b); and any person who is retained or hired by a person described above to provide any services to a response action.

[2]50 U.S.C.A. § 1431 (West 1991 & Supp. 1993).

[3]10 U.S.C.A. § 2354 (West 1993).

[4]42 U.S.C.A. § 9619 (West 1983 & Supp. 1993).

[5]This report deals only with contract indemnity and does not discuss tort indemnity. *See generally Cities Service Co. v. Lee-Vac, Ltd.*, 761 F.2d 238, 240-41 (5th Cir. 1985).

[6]There are instances of the environmental restoration contractors indemnifying the government for certain liabilities under certain circumstances, but these are not addressed here.

[7]*See generally* 42 C.J.S. *Indemnity* § 2 (1991 & Supp. 1993). Some courts distinguish the terms "indemnify against liability," "indemnify against loss," and "hold harmless." *See New York Cent. R.R.. Co. v. General Motors Corp.*, 182 F. Supp. 273, 290-91, (N.D. Ohio 1960). (Indemnification against liability would provide a contractor with the right to recover from the United States as soon as the contractor's liability had become fixed and established, even though the contractor had not yet sustained actual loss or damage. Indemnification against loss would give a contractor the right to recover from the United States only when it had made payment or otherwise suffered an actual loss or damage covered by the indemnification agreement. To hold harmless would be to assume all expenses incident to the defense of any claim in addition to fully compensating the contractor for all loss or expense.) For purposes of this report, these terms are treated as synonymous with the term "indemnify."

[8]Covered events are defined in the contract. An example of a covered event might be the explosion of rocket propellants in a contract to manufacture rockets.

ENDNOTES (Continued):

[9] *See generally* U.S. General Accounting Office, Office of General Counsel, Principles of Federal Appropriations Law, 6-41 (1982).

[10] 31 U.S.C.A. § 1341 (West 1983 & Supp. 1993).

[11] *In re U.S. Park Police Indemnification Agreement*, B-242146, 16 August 1991 (unpublished); *In re Assumption by Government of Contractor Liability to Third Persons*, 62 Comp-Gen. 361, 364-65 (1983).

[12] *See* National Defense Contract Act, Pub. L. 85-804, 10 U.S.C.A. § 2354 (West 1993) and CERCLA, 42 U.S.C.A. § 9619 (West 1983 & Supp. 1993).

[13] *See* 10 U.S.C.A. § 2354 (West 1993).

[14] Hamilton, Lee *Government's Hidden Risks*, Journal of Commerce, 30 October 1989.

[15] It is also very important that use of indemnification not reduce the incentive for contractors to perform high-quality, safe work. *See Department of Defense Remedial Action Contractor Liability and Indemnification: Hearing Before the Environmental Restoration Panel of the House Comm. on Armed Services*, 102nd Cong., 2nd Sess. 105 (1992).

[16] 50 U.S.C.A. § 1431 (West 1991).

[17] Executive Order No. 10789, 23 Fed. Reg 8897 (1958), *reprinted as amended in* 50 U.S.C.A. § 1431 (West 1991).

[18] Concern about the breadth of the powers generally and the possible creation of "enormous contingent liabilities" under the indemnification provisions led to the perception that "these powers should be subjected to the scrutiny of the entire Congress and the public." H.R. REP. No. 2232, 85th Cong., 2d Sess. 2, 7 (1958). This "scrutiny" took the form of the statutory requirements that Pub. L. 85-804 actions be made a matter of public record, 50 U.S.C.A. § 1433(a), and that all such actions be reported annually to Congress and published in the *Congressional Record*, 50 U.S.C.A. § 1434 (West 1991 & Supp. 1993).

[19] Letter to Hon. Les Aspin from Hon. John D. Dingell, et. al., dated 15 September 1992 (*see* Appendix 1).

ENDNOTES (Continued):

[20] Letter to Hon. Les Aspin from Hon. Mike Synar, dated 6 August 1992 (*see* Appendix 1).

[21] FAR 52.250-1(d).

[22] FAR 50.402(a).

[23] 40 C.F.R 260-270 (1992).

[24] 56 Fed. Reg. 5068 (1991).

[25] Executive Order No. 10789 1A(a), 23 Fed. Reg 8897 (1958), *reprinted as amended in* 50 U.S.C.A. § 1431 (West 1991); FAR 50.401. DoD has consistently maintained that indemnification should only be provided when contractors are unable to obtain adequate commercial insurance to cover the unusually hazardous risks of performing certain government contracts. *See* H.R. REP. No. 2232, 85th, Cong., 2d Sess. 6 (1958) ("The Department of Defense and the committee believe, therefore, that to *the extent that commercial insurance is unavailable*, the risk of loss should be borne by the United States) [emphasis supplied].

[26] Letter to Hon. John Dingell from American Law Division, Congressional Research Service, *Whether PL 85-804 Authorizes Federal Defense Agencies to Indemnify Hazardous Waste Cleanup Contractors*, 27 August 1992 (*see* Appendix 1).

[27] Letter to Hon. John Dingell from American Law Division, Congressional Research Service, *Whether PL 85-804 Authorizes Federal Defense Agencies to Indemnify Hazardous Waste Cleanup Contractors*, 27 August 1992 (*see* Appendix 1).

[28] Memorandum to Deputy Under Secretary of Defense for Environment, from William McGowan, Office of Judge Advocate General, dated 5 May 1993 (*see* Appendix 1).

[29] *Coastal Corp. v. United States*, 713 F.2d 728,731 (Fed. Cir. 1983).

[30] 50 U.S.C.A. § 1434 (West 1991).

[31] DoD *Defense Environmental Restoration Program Annual Report to Congress for FY 1992*, (*see* page 54), April 1993.

ENDNOTES (Continued):

[32]*EPA Superfund Innovative Technology Evaluation (SITE) Program -Technology Profiles*, Office of Research and Development, EPA/540/5-90/006, November 1990.

[33]DFARS 252.235-7000 (b) and 252.235-7001 (b). The clauses do not directly address contractor pollution liability, which in some instances might be more extensive than the "loss, damage, or lost use of property" covered in the clauses.

[34]10 U.S.C.A. § 2354(a) (West 1983). As with indemnification under Pub. L. 85-804, it is unlikely that routine cleanup activity involving chemical residues similar to those found in the commercial sector would generally qualify as an unusually hazardous activity.

[35]For example, some courts disagree whether cleanup costs constitute damages within the meaning of a liability insurance policy requiring the insurer to pay damages that the insured becomes legally obligated to pay because of property damage. *Continental Insurance Companies v. NEPACCO*, 842 F.2d 977 (8th Cir.) *cert. denied*, 109 U.S. 66 (1988). *cited in*, Seymour, John F., *Indemnification of Cleanup Contractors at Federal Facilities*, 1993 (*See* Appendix 1).

[36]DFARS 252.235-7000(h); 252.235-7001(i).

[37]Pub. L. 85-804 would apply to the non-research and development work; 10 U.S.C.A. § 2354 would apply to research and development work. DFARS 235.070-2.

[38]10 U.S.C.A. § 2354(d) (West 1983).

[39]DFARS 252.7000(j), DFARS 252.7001(k).

[40]DFARS 252.235-7000(c).

[41]58 Fed. Reg. 5987 (1993).

[42]Superfund—*Contractors are Being Too Liberally Indemnified by the Government*, GAO/RCED-89-160.

[43]Seymour, John F., *Indemnification of Cleanup Contractors at Federal Facilities*, 1993 (*see* Appendix 1).

[44]58 Fed. Reg. 5978 (1993).

ENDNOTES (Continued):

[45]42 U.S.C.A. § 9619(c)(4) (West 1983 & Supp. 1993).

[46]42 U.S.C.A. § 9619(c)(5)(B) (West 1983 & Supp. 1993).

[47]*See* 42 U.S.C.A. § 9619(e)(1),(2) (West 1983 & Supp. 1993).

[48]In 42 U.S.C.A. § 9601 (24), the term "remedial action" is defined as action consistent with a permanent remedy taken in the event of a release or threatened release of a hazardous substance into the environment. The definition of *"removal"* in 42 U.S.C.A. § 9601 (23) deals with actions of a temporary nature. *See Amland Properties Corp. v. Aluminum Co. of America*, 711 F. Supp. 784, 794-95 (D.N.J. 1989).

[49]National Defense Authorization Act for Fiscal Year 1993, Pub. L. 102-484, § 332 (1993).

[50]This section, 42 U.S.C.A. § 9619 (West 1983 & Supp. 1993), was added by the Superfund Amendments and Reauthorization Act of 1986 (SARA) and is sometimes referred to as Superfund indemnification.

[51]The Secretary of Defense was delegated limited § 119 authority by Executive Order No. 12580, 52 Fed. Reg. 2923 (1987).

[52]DoD *Defense Environmental Restoration Program Annual Report to Congress for FY 1992 (see* page 5, paragraph 1), April 1993.

[53]40 C.F.R. Part 300, Appendix A "The Hazard Ranking System" (1992).

[54]DOE management—*Consistent Cleanup Indemnification Policy Is Needed.* GAO/RCED-93-167.

[55]42 U.S.C.A. § 9619 (West 1983 & Supp. 1993). § 9619(a) eliminated RAC liability under federal law for remedial activities, absent contractor negligence or misconduct, but did not pre-empt claims arising under state law. § 9619(c) *authorizes indemnification of RACs* for liability based on negligence, but not for liability based on gross negligence, intentional misconduct, or strict liability, and also does not pre-empt state law claims. *See* 58 Fed. Reg. 5978 (1993).

ENDNOTES (Continued):

[56]58 Fed. Reg. 5972 (1993). EPA was delegated the responsibility under § 9619(c)(7) to promulgate regulations for indemnification by Executive Order No. 12580, 52 Fed. Reg. 2923 (1987).

[57]58 Fed. Reg. 5972 (1993). EPA was delegated the responsibility under § 9619(c)(7) to promulgate regulations for indemnification by Executive Order No. 12580, 52 Fed. Reg. 2923 (1987).

[58]58 Fed. Reg. 5974 (1993).

[59]58 Fed. Reg. 5985-86 (1993). Contractors may negotiate on the limit and deductible, but the upper limit they may select is determined by the dollar amount of the contract. Coverage of $75 million is the top limit, and is available only for contractors with contracts longer than five years. The top limit for all other contractors is $50 million. The deductibles are equivalent to 1 percent of the limit amount for limits of $25 million or below, and 2 percent if the limit amount is $50 million. Amounts above $50 million are subject to a dollar-for-dollar copayment by the contractor. Lower deductibles are available for innovative technology contractors. Contractors have generally adopted the view that the EPA guidelines set the amount of indemnification too low, the deductibles too high, and the time duration too short. *See e.g., Department of Defense Remedial Action Contractor Liability and Indemnification: Hearing Before the Environmental Restoration Panel of the House Comm. on Armed Services,* 102nd Cong., 2nd Sess. 105 (1992).

[60]58 Fed. Reg. 5979 (1993).

[61]42 U.S.C.A. § 9619(c)(3) (West 1983 & Supp. 1993). EPA guidelines also state that if other federal agencies indemnify contractors under § 119, those agencies must use their own appropriations to pay all indemnification costs. 58 Fed. Reg. 5987 (1993).

[62]The term of indemnification extends for ten years after termination of the contract.

[63]58 Fed Reg. 5979 (1993).

[64]58 Fed Reg. 5979 (1993).

ENDNOTES (Continued):

[65]40 C.F.R. Part 300, Appendix A "The Hazard Ranking System" (1992).

Chapter 3: Adequacy of Competition

Response to § 332, Paragraphs (2) and (3)

Paragraph (2): The extent to which the authorities referred to in paragraph (1) are available to ensure adequate competition and qualified contractors for actions not governed by the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (42 U.S.C.A. 9601 et seq.), and the extent to which additional authority to ensure adequate competition and qualified contractors is necessary for such actions.

Paragraph (3): The extent to which the indemnification authority provided in § 119 of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 is necessary to ensure adequate competition and qualified contractors to perform remedial actions at military installations listed on the National Priorities List or removal actions pursuant to such Act.

SYNOPSIS

Environmental restoration at DoD sites is addressed via DERP. Although conducted in accordance with CERCLA,[1] response actions undertaken by this program are not limited to CERCLA NPL sites. As noted in Chapter 2, the great majority of DoD installations are not listed on the NPL, and thus may not be eligible for the indemnification provided in CERCLA § 119. In other respects, the qualitative differences between NPL and non-NPL sites are minimal, and the issues regarding competition and quality of contractors are common to both situations. Therefore, DoD has chosen to respond to Paragraphs (2) and (3) together. There is a common question addressed in the two paragraphs: To what extent is indemnification needed to ensure adequate competition and qualified contractors?

To respond to these issues, DoD has examined the available data regarding contracting and indemnification, and has looked at the relationship between risk management and competition. A review of the status of the DoD restoration program, an analysis of the risks associated with environmental restoration, and a survey of the characteristics of the contractor community were undertaken to further define adequate competition and qualified contractors.

DERP has yet to face the majority of its remedial actions, but is rapidly approaching a shift in the program where remediation dominates contract solicitations. Although risks arise in all phases of investigation and cleanup, the exposure to liability may increase as activities that disturb, remove, treat, transport, or dispose of wastes take place. While current data is limited to case studies, the representatives of the contractor community, and certain large firms in particular, state that these combinations of circumstances make their continued competition for DoD environmental restoration contracts too risky. On the other hand, firms appearing on the *Environment Today*'s[2] list of the top 100 environmental contracting companies routinely appear as bidders and winners on DoD environmental restoration contracts.

From the standpoint of DoD, competition in environmental restoration contracting is desirable to obtain the best value. To date, DoD has had no difficulty in obtaining sufficient numbers of qualified bidders for environmental restoration work without offering indemnification. However, there are indications that major DoD contractors and many large environmental firms are not participating in DoD environmental restoration work. It is unknown whether these segments are declining to bid because of indemnification issues, or whether these segments could provide better value to the environmental restoration efforts of DoD. Several large acquisitions currently under way may provide DoD an opportunity to better evaluate the issue of adequate competition, including whether there is, indeed, a relationship between indemnification and the level of competition. The limited evidence to date from EPA and the state of New Jersey, both of whom routinely offered indemnification in the past but no longer do so, indicates that there is no noticeable relationship between indemnification and the level of competition.

CURRENT DATA ON CONTRACTING AND INDEMNIFICATION

DoD has not provided indemnification to environmental restoration contractors, so the evidence will be limited to the results of competitions conducted without it. (Examples of DoD's use of the indemnification authorities described in Chapter 2 are contained in Chapters 5 and 7).

The DoD Components provided procurement information and data to this study for purposes of helping ascertain whether adequate competition currently exists for environmental contracts and to what extent indemnification is needed to ensure that it exists.

The data was provided in response to an information request from the Office of the Assistant Secretary of Defense (Environmental) (OASD[E]).[3] The data provided is highly variable in coverage and completeness among the components. The Navy provided the most comprehensive data set, which contained considerable data on their environmental contracts. These included data for both architect-engineer and construction contracts that were both fixed-price and cost-reimbursement contract types.

The Defense Logistics Agency provided no data on its environmental contracting, stating that since indemnification was not an issue in their contracting efforts, there was no need to provide additional information. The Air Force and Army provided summary level information on the environmental contracts awarded in their respective services over a limited time period and only at the command or service center level.

For the solicitations reported on by the DoD Components, only 2 of 78 solicitations received as few as two respondents, whereas most had ten or more. This pattern held for contracts ranging from $5 million to $260 million.[4]

The data provided by the DoD Components indicates that, in general, adequate competition and qualified contractors have been the norm to date for DoD environmental restoration work. This has occurred without the need to exercise the indemnification authorities available to DoD, such as CERCLA § 119 or Pub. L. 85-804. For this reason, DoD has not sought additional indemnification authority.

However, the data referred to above do not necessarily demonstrate what impact the lack of indemnification may have had on the contracting process, or may have in the future. For example, it is difficult to obtain information on companies that refused to bid because indemnification was not offered. In addition, there have been few solicitations to date for major remedial action contracts; this inhibits the extrapolation of the currently available data to future conditions. Therefore, DoD examined specific solicitations where some of these issues were raised.

The Air Force Center for Environmental Excellence at Brooks Air Force Base published a draft request for proposals for a large ($1.1 billion) remediation project. Approximately one half of the comments submitted in response expressed concern over the lack of indemnification offered by the Air Force and suggested the inclusion of some type of risk-sharing mechanism.[5] This solicitation is currently in the source selection process. Once the source selection process is complete, DoD can perform an analysis of the number and type of respondents and a comparison of the respondents to commenters. This analysis will help DoD further define the impact indemnification, or the lack thereof, has on the contracting process.

In the course of developing guidelines for indemnification under CERCLA § 119, EPA also examined the issue of the impact of indemnification on contracting. Acknowledging the limited data then available, EPA requested additional information from the contracting community. Despite a large number of comments on their proposed guidelines, EPA received no additional factual data supportive of any particular indemnification policy. EPA's final guidelines were based on an attempt to ensure an adequate pool of contractors balanced against EPA's financial responsibility for Superfund moneys.[6]

Subsequent to the publication of the final EPA guidelines, which provide no indemnification in new procurements, EPA awarded 9 remedial design contracts (totaling $3.7 million) and 11 remedial action contracts (totaling $100 million). Each contract received adequate competition according to EPA's standards and was awarded without the offer of indemnification. EPA has three solicitations for environmental restoration work in progress, with indications that they will result in sufficient competition despite not offering indemnification.[7] One implication of EPA's recent experience with the new guidelines is that, for all practical purposes, indemnification terms are no different for EPA or DoD contract solicitations. Contractors operating in the federal arena that could previously obtain indemnification for EPA work under CERCLA § 119, and thereby avoid the uncertain liabilities associated with DoD work, now face similar risks in either program. Whether this will result in increased competition for DoD work is unknown at the present time.

Some data on the adequacy of competition is available from those states offering indemnification. For example, New Jersey offered indemnification in the past and then ceased offering it. The state has not observed any decline in the number or quality of firms responding to environmental restoration solicitations, although a few individual firms may now decline to bid. (This issue is discussed in more detail in Chapter 5).

RISK MANAGEMENT AND COMPETITION

The available data regarding the number and competency of firms responding to solicitations show that adequate competition currently exists. However, the data are insufficient to conclude that DoD is necessarily obtaining the best environmental restoration value possible.

Competition must be thought of not only in terms of the number of respondents, but also whether the companies with the right qualifications are responding. Indeed, the issues of competition and quality of respondent are inseparable in this context. As a result, both DoD and the contractor community have vested interests in increasing competition for remedial action contracts. For DoD, increased competition means better application of cleanup technologies, including innovative technologies, at the most reasonable price to the government. For the contractor community, increased competition is an indicator of a more favorable business environment, one in which contractors freely enter the market and are willing to propose innovative solutions to hazardous waste problems. In order to examine this issue in more detail, the relationships between risk, competition, and quality of contractors must be explored.

The issue of adequate competition in the environmental restoration marketplace is linked to a company's ability to manage risk—in this case, the risks associated with the various liabilities a company is exposed to in the course of performing environmental restoration. There are two broad strategies a company has for dealing with risk it does not wish to assume: (1) reduce or shift the penalties that might accrue from realized liabilities, or (2) reduce exposure to liability.

The first strategy for risk management has focused on the purchase of insurance (where available and adequate) and indemnification to limit the financial risk to environmental restoration contractors. Because insurance may be difficult to obtain at a reasonable price and have significant limitations in its coverage, it generally has not been a practical solution to the issue (*see* Chapter 6). In addition, indemnification has not been widely provided.

The inadequacy or unavailability of strategies for shifting the burden of liability leaves the concerned contractor with the only remaining option—reducing exposure to liability. This can be accomplished by refusing certain types of work (an option open to individual contractors[8] that has not been practiced to date by the marketplace as a whole), creating subsidiaries or other business strategies designed to protect the assets of the parent company,[9] or performing work in a manner that increases the certainty of environmental decision making. DoD insists on quality work and holds environmental restoration contractors to a high standard of performance. However, certainty is often an unattainable goal in environmental work, either in the determination of the nature and extent of contamination or the selection of an appropriate remedial technology. Extending the investigation phase of site restoration in an attempt to achieve certainty in an uncertain environment and avoiding innovative technologies and solutions that may carry a higher risk of failure are strategies that may be taken by the contractor in an effort to minimize its liability. These strategies have drawbacks both for the contractor community and the government. An overly conservative approach to cleanup is no guarantee against possible future liability for the contractor, nor is it always consistent with DoD goals of using the most effective technologies, including innovative technologies, to expedite cleanup in a manner protective of human health and the environment.

Some members of the contractor community have expressed concern about their ability to compete on future remedial action contracts without access to some type of risk management. This is not a universal concern, as evidenced by the number of firms that do compete, but has been strongly expressed by a few prominent firms and trade associations. The remedy discussed most often is some form of indemnification. To fully consider the need for indemnificationand its impact on competition, it is necessary to assess if the adequate competition shown by the current data is likely to be maintained in the future as the restoration program matures. This can be done by examining (1) the progression of the restoration program from investigation to cleanup, (2) the opportunities for exposure to liabilities, and (3) the character of the environmental restoration contractor community.

Conventional wisdom regarding the impact of liability on competition within the restoration contractor community rests on three main assumptions. First, that the majority of contracts let to date in the DoD environmental restoration program deal with the investigation phase, and that as the program matures, more and more work will be done in the cleanup arena. Secondly, it has been assumed that exposure to liability increases as the

program proceeds. That is, remedial design and remedial action contractors performing cleanup work are assumed to be at greater risk than are contractors performing the investigation work associated with preliminary assessment/site investigation or remedial investigation/feasibility study (RI/FS) projects. Finally, because of the unique qualities that a diverse population of firms can apply to the problem, it is argued that both large and small firms will be required for the successful completion of remedial projects. The characteristics of those segments of the contracting community, the determination of their ability to compete, and an examination of the current makeup of the remedial action contractors already under contract will help determine whether DoD is attracting sufficient contractors with the right qualifications.

PROGRESS OF THE DEFENSE ENVIRONMENTAL RESTORATION PROGRAM

DoD has made significant progress in moving the environmental restoration program into the remediation phase. Looking at data presented in DERP's Annual Reports to Congress for Fiscal Years 1990, 1991, and 1992, the number of site investigations planned continues to decline (from 1,263 in 1990 to 757 in 1992), as sites move into the RI/FS phase.[10] Remedial design/remedial action (RD/RA) continues to account for larger and larger percentages of the activity under way at all bases. However, the number of RA activities projected for the future still outweigh completed RD/RA projects by an approximate 15-to-1 ratio (4,280 to 289).[11]

The shift in the program away from investigation and toward cleanup has two significant implications. First, regardless of the measurement used, data collected to date on the amount of competition and the quality of contractors has only limited utility in describing future scenarios of increased attention to actual cleanup.

Second, DoD is not alone in making this shift. EPA and DoE are undertaking concerted efforts to remediate sites and are also moving towards programs dominated by the cleanup phase. The capacity of the marketplace to meet all of these challenges, although not addressed in this report, could affect the level of competition and the contracting strategies that must be employed to ensure that DoD obtains the best value in environmental restoration contracting.

PROGRAM RISKS

The basic elements of the overall environmental restoration program include investigation, design, construction, and operation and maintenance. The latter three of these comprise the cleanup phase. Within each of these elements, a variety of prime contractors and subcontractors are involved in such functions as surveying, sampling, drilling wells, designing and building remedies ranging in complexity from earthen walls to sophisticated treatment plants, transporting and disposing wastes, and operating and maintaining treatment systems.

The liabilities that contractors may be exposed to are discussed in greater detail in Chapter 4. Simply put, liabilities can be incurred at any phase of the restoration program. They may result from the disturbance, removal, transport, or disposal of hazardous substances, any of which can result in releases to the environment and create liability for cleanup costs, or for property damage or personal injury (tort damages). Professional liability can result from the implementation of a remedial design that ultimately fails to contain wastes, despite the application of best business principles and practices.

Because of the inherent uncertainty involved while the nature and extent of contamination is still being explored, negligence on the part of a contractor that results in a release to the environment can also occur at the investigation phase. Several cases exist in Superfund where groundwater contamination, for example, has been made worse via the inadvertent actions of a contractor involved in drilling wells for its investigations.[12] However, the exposure to suit is generally assumed to increase as waste removal, treatment, transport, or disposal activities increase, and as design, construction, and operation of a treatment or containment system proceeds. The proximity to the damage, both in space and time, make the "hands-on" contractor a more obvious target of litigation than one at earlier stages of the multiyear cleanup process. Therefore, DoD experience to date may not form an adequate database from which to determine the need for indemnification as an incentive for contractors to bid on DoD work at reasonable prices.

CHARACTERISTICS OF THE CONTRACTOR COMMUNITY

A look at the companies that have successfully bid on environmental restoration contracts at DoD in the past shows a range of sizes. Represented within this list are several of the largest environmental engineering firms in the business, as well as several smaller firms that may specialize in a particular technology. These two categories each have qualities affecting their ability and willingness to compete for future DoD remediation contracts.

Large companies may offer several benefits to the government, particularly in the performance of large remedial contracts. In theory, these companies have experience with large, complex projects and can bring the relevant management and technical skills to bear. Serving as the focal point for the government, they can streamline remedial efforts by coordinating the activities of subcontractors. The largest contractors for DoD are primarily engaged in weapons systems development involving all the steps of the systems development life cycle, from research and development through testing and evaluation to actual production. These firms have expertise in moving from conceptual notions of system functionality to manifesting those notions in completed hardware and corresponding support infrastructure, and on the face of it, should be able to transfer that ability to the environmental restoration field. Some of the larger companies, however, are the very companies most vocal in their expression of need for risk-sharing mechanisms to encourage their participation in the remedial action contracting arena. Their argument is twofold: they have the most to lose in exposing assets to liability; like all other environmental restoration contractors, they also have difficulty obtaining adequate insurance and surety bonding[13] for the unknown risks associated with large remediation projects (*see* Chapter 6).

Small businesses (those with less than 250 employees) account for 99.7 percent of all companies and 70 percent of U.S. employment.[14] The American Defense Preparedness Association states that as projects exceed $3 million (particularly environmental restoration/construction projects), small contractors are less likely to be able to compete. Concerns over financial stability and overexposure limit the availability of surety bonds required by the Miller Act, freezing these companies from the marketplace as prime contractors. EPA has recognized the importance of these companies in providing innovative technology and has attempted to ensure their participation in the Superfund Program by liberalizing the indemnification coverage and deductibles available to them under CERCLA § 119.[15]

Major DoD Contractors and Environmental Restoration Contracting

In 1990, the 100 largest DoD contracting firms had DoD-related revenues in excess of $100 billion, with the ten largest firms in excess of $50 billion. Only one of the ten largest DoD contracting firms has had any significant presence in the environmental contracting field. Raytheon Engineers and Constructors, a subsidiary of Raytheon founded in 1993, appeared on the *Environment Today*'s "Top 100" list of environmental contractors for the first time this year, weighing in at number 7, with reported environmental revenues of $250 million.[16]

In the DoD data examined to date, of the ten largest DoD contractors, only a subsidiary of one of them has entered any bids for environmental work solicited by DoD. This was a single unsuccessful bid for a Navy contract that was awarded to another bidder with a fixed price of about $500,000.[17] Most of this subsidiary has since been sold to another company.[18] It is not clear from the data provided why the largest DoD contractors have not vigorously joined the market for DoD environmental work. Some reasons might include a lack of familiarity with the environmental business and a scarcity of in-house expertise with the technology, or strategic business decisions about future growth markets and company positioning. How much these reasons versus the lack of indemnification influence the participation of large defense firms in environmental restoration contracting remains an open question.

Major Environmental Firms and DoD Work

Many other firms prominent in the environmental and construction business are apparently not working for DoD's environmental programs either. A preliminary comparison shows that only 17 firms named on the *Environment Today*'s "Top 100" list are among the contractors' names submitted in the response to the information request from the components. Again, the responses received from the components were not comprehensive and many firms working at lower levels (e.g., at the installation level) within the components may not have been reported. No attempt was made to identify subsidiaries of companies that might be doing

business under different names. Also, the *Environment Today*'s "Top 100" list is not necessarily a comprehensive compilation of all the major firms performing under contracts that could be considered as environmental restoration work.

Specific Contractor Assertions

Several major construction and engineering services contractors have stated that the risk they face in performing on DoD environmental projects is too extreme. They often assert that because of the lack of indemnification they are being asked to "bet the company" just to perform on DoD environmental contracts, a risk they claim they will not take. Representatives from Bechtel Corp.[19] and EBASCO,[20] both among the largest engineering and construction contractors in the country, have made this assertion at different times, and the National Securities Industry Association articulates this point of view for the whole industry.[21] However, as discussed below, both these companies have recently bid on and won major Navy environmental restoration contracts without indemnification being offered.

Participation in carefully selected environmental restoration contracts is a business decision involving many considerations including capacity utilization, staffing issues, and risk/reward considerations. Companies sometimes weigh the risks involved with performing on a particular contract and conclude that, in some situations, they can accept the risk of participation in government environmental work without contractual risk-sharing arrangements.[22] Both Bechtel Corp. and EBASCO apparently reached that conclusion. Bechtel won a Navy "CLEAN" contract in April 1993 and EBASCO won a Navy Remedial Action Contract in June 1993. Neither of these contracts includes indemnification provisions. The fact that Bechtel and EBASCO have accepted environmental restoration contracts without indemnification may indicate that even companies vocal in their demands for indemnification actually will choose to bid without it when presented with a real solicitation. On the other hand, these cases might be specific business decisions given the current market and the particular risks of the work to be done.

Analysis of Navy Data

Navy data supplied in response to DoD's information request was the most detailed. A preliminary reading of this data set[23] indicates that during FY 1991 and 1992 the Navy issued 52 "cleanup contracts" to 39 cleanup contractors for a total of $167 million in cleanup work. On these 39 contracts, 382 bids (and proposals) were received from 276 different contractors. Of these, the most significant subset are those cost-reimbursement contracts for RACs. While only 8 RAC contracts were awarded, they comprise $150 million of the $167 million total dollar volume contracted in this time period.

The solicitation for RAC contracts attracted 70 proposals for the eight contracts that were to be awarded. From among the 70 proposals, five contractors were selected to receive the eight awards. One contractor won three contracts, for a 27 percent share of the total awarded dollar amount, while another contractor won two contracts for a 33 percent share of the total awarded amount. The remaining 40 percent share was distributed among the other three successful proposers. That 70 proposals were received for RAC work seems to indicate that adequate competition was achieved, but it is not evident from the data how diversified the proposer population was for each of the eight contracts. Also, since 60 percent of the RAC contract total funding was concentrated with just two contractors, it might indicate a constrained market for qualified contractors willing to participate.

Reported Contractor Quality and Financial Strength

The Navy provided a large volume of background data on the performance quality and financial strength of many of the contractors that were successful in acquiring Navy cleanup contracts.[24] The data was provided from the Navy's Engineering Field Divisions for environmental design and remedial action types of work. The sample does not reflect Army or Air Force experience.

The following is a preliminary interpretation of the information provided by the Navy and represents a reasonable explanation for the distribution of the data; it may represent only one of many such explanations.

The Navy data offer the opportunity to examine the quality of the work that is provided by the construction contractors working on cleanup. Of the 340 contractor evaluations reviewed, only 18 occurrences of "unsatisfactory" were reported, while 43 instances of "outstanding" were reported. The other option on the three-point scale, "satisfactory," was scored for the

remaining 279 occurrences. By and large, data for this set of contractors shows no extreme degree of dissatisfaction with the services that are being provided.

The Navy data also provide an opportunity to make some inferences about the financial strength of the Navy construction contractors used in cleanup by examining their net worth as a group. The Navy contractors range in net worth from $60 thousand to about $130 million, or a range of over three orders of magnitude. Of the 50 contractors the Navy provided information about, 22 had a net worth of less than $1 million, and 43 had a net worth of less $5 million. 5 contractors had reported net worth values in excess of $10 million, while 2 had a net worth in excess of $100 million. This information suggests that most Navy contractors for which the information was provided would find it difficult to meet a major personal injury claim, especially one involving a number of injured parties, brought under the liability theories discussed in Chapter 4.

Data Analysis Summary

The data indicate that DoD is currently receiving adequate numbers of responses from qualified bidders for environmental restoration work. However, determining the "adequacy of competition" may require more than a simple bid count. For example, are important segments of the contracting community declining to bid on non-indemnified work? Would contracting with those segments enable DoD's environmental restoration program to progress more efficiently, providing better cleanups at lower costs? If a large number of firms decide that cleanup work exposes the contractor to increased liabilities when compared to investigation work, will fewer firms bid on the increasing number of DoD contracts that address actual cleanup?

Based on the limited data analyzed, there are a few observations that can be offered about competition in DoD environmental restoration contracting that may help provide some insight into answering these questions:

- The data available are incomplete.
- Several major environmental engineering firms are bidding and winning DoD environmental restoration contracts. However, many more major environmental engineering firms are not participating in DoD environmental restoration contracting.
- Both large and small firms are bidding and winning DoD environmental restoration contracts.
- Major DoD contractors do not participate in DoD environmental restoration contracting.
- Contractor quality does not appear to be a problem at present.
- Contractor financial capacity, as measured by net worth, is probably insufficient to meet a major personal injury claim brought under the liability theories discussed in Chapter 4 using internal resources only.

ENDNOTES:

[1] Comprehensive Environmental Response, Compensation, and Liability Act, as amended by the Superfund Amendments and Reauthorization Act of 1986 (Superfund) 42 U.S.C.A. § 9601-9671 (West 1983 & Supp. 1993).

[2] *Environment Today*. Vol. 4 No. 7, July 1993.

[3] OASD(E) letter dated 8 January 1993. This letter requested extensive information regarding the environmental contracting experience within the components and the question of what role, if any, indemnification played in any acquisitions (*see* Appendix 2).

[4] *See* Appendix 2.

[5] Memorandum for Deputy Assistant Secretary (Environment), from Gary D. Vest, Deputy Assistant Secretary of the Air Force (Environment, Safety and Occupational Health), undated (*see* Appendix 1).

[6] Superfund Response Action Contractor Indemnification, Final Guidelines, 58 Fed. Reg. 5972 (1993).

[7] Summary of Competition without Indemnification in FY93, EPA memorandum dated 22 October 1993 (*see* Appendix 2).

[8] The National Constructors Association (NCA), in a statement for the record before the Readiness, Sustainability & Support Subcommittee of the Committee on Armed Services concerning the Environmental Restoration Program and Contractor Liability Issues (12 May 1992), claims that contractors are "walking away from Defense Department remediation contractors which do not offer adequate liability protections." NCA cites one specific case in which EBASCO refused to sign a Navy RAC contract because FAR clause 52-228-7 (offering cost reimbursement) was "so severely restricted as to afford virtually no protection to the contractor." Bechtel, IT Corporation, Lockheed, and Martin Marietta have expressed similar positions in testimony to Congress, namely that these corporations will not bid or would bid on a very selective basis on DoD remediation projects that do not offer some risk-sharing mechanism. (Senate Hearings before the Environmental Restoration Panel of the Committee on Armed Services, House of Representatives, *Department of Defense Remedial Action Contractors Liability and Indemnification*, 10 March 1992.)

ENDNOTES (Continued):

[9] The use of subsidiary corporations to assume the risks of catastrophic claims has not been tested in the specific context discussed here. Such strategies have been applied in protecting assets from CERCLA liabilities, generally resulting in a less rigorous test than is found in common law for "piercing the corporate veil."

[10] Because DoD has updated its record keeping to remain consistent with changes in the Superfund program (such as the introduction of the Superfund Accelerated Cleanup Model), terminologies and data types are not strictly comparable from one report to the next.

[11] Defense Environmental Restoration Program, Annual Report to Congress for Fiscal Year 1992, April 1993.

[12] For example, in responding to comments on the proposed NPL listing of FCX, Inc. (Support Document for the Revised National Priorities List Final Rule, February 1990), EPA agreed that the contaminant caprolactam had been introduced into the groundwater during field activities. In the same document, responding to comments on the proposed listing of Helena Chemical, EPA noted that a monitoring well had been installed through fill material, and that this action could have facilitated the contamination of groundwater.

[13] The Miller Act requires performance and payment bonds for any construction contract exceeding $25,000. Surety bonding ensures that the contractor's obligation to the government will be met. Surety firms look at a contractor's record, financial capacity, experience, insurance coverage, and other factors to ensure contracts go only to qualified contractors. Performance bonds guarantee full and faithful fulfillment of contract requirements. Payment bonds guarantee payment to suppliers and subcontractors.

ENDNOTES (Continued):

[14]Lt. General Lawrence Skibbie, President, American Defense Preparedness Association, statement presented in a hearing before the Environmental Restoration Panel of the Committee on Armed Services, House of Representatives, *Department of Defense Remedial Action Contractor Liability and Indemnification*, 10 March 1992.

[15]Superfund Response Action Contractor Indemnification, Final Guidelines. *Indemnification of Innovative Technology RACs and SITE Participants*, 58 Fed. Reg. 5981 (1993).

[16]*Environment Today*. Vol. 4 No. 7, July, 1993.

[17]Several major defense firms, or their subsidiaries, have performed cleanup activities at both government and contractor facilities as part of other ongoing duties, and such work has often been paid for by the government.

[18]Dun & Bradstreet, citing published news reports.

[19]Mr. Richard J. Tosetti, Bechtel Corporation. Statement presented in a hearing before the Environmental Restoration Panel of the Committee on Armed Services, House of Representatives, *Department of Defense Remedial Action Contractor Liability and Indemnification*, 10 March 1992.

[20]Dr. Michael E. Yates, Senior Vice President, EBASCO Environmental Services, statement presented in a hearing before the Environmental Restoration Panel of the Committee on Armed Services, House of Representatives, *Department of Defense Remedial Action Contractor Liability and Indemnification*, 10 March 1992.

[21]National Security Industries Association, Interagency Subcommittee, *Contractor Liability and Indemnification White Paper*, Defense Industry and the Environmental Agenda—Symposium '91, held in Tyson's Corner Virginia, 9-10 October 1991 (*see* Appendix 1).

[22]One influencing factor may be the coverage of available insurance for the particular contract. The availability, coverage, and cost of insurance is further discussed in Chapter 6.

ENDNOTES (Continued):

[23]Considerable uncertainty regarding the source of the data remains. It is not clear if the data relates to the entire component or to some subdivision of commands. Further, the nature of the work for each contract is not specified, definitions of "remedial action," "cleanup contract" and other work needs some elaboration, and contracts obtained in ways other than sealed bid are apparently not included. Nonetheless, the Navy provided a great deal of information that should be useful for the immediate purposes, and it also points the way for further inquiries.

[24]Includes proprietary information.

Chapter 4: Contractor Liabilities

Response to § 332, Paragraph (4)

Paragraph (4): The extent to which contractors performing environmental restoration work at installations and sites referred to in paragraph (1), other Federal sites, and private sites have been exposed to, or involved in, litigation, claims, and liability related to such environmental restoration work since 1980.

SYNOPSIS

Contractors are concerned that they may find themselves subject to strict, joint, and several liability for increased remediation costs, property damages (especially if contamination migrates beyond site boundaries), immediate personal injuries, and adverse exposure-related health effects that may not appear for many years. Contractors are particularly concerned that under some circumstances, they could be liable for the entire cost, as no other party could be held liable or would be able to pay. In principle, contractors can become liable for cleanup costs under the strict liability (liability without fault) rule of CERCLA. They may also be liable for damages or personal injury under state law for negligent acts, and to the extent the courts deem an activity "ultrahazardous," for non-negligent acts. However, these contractor concerns have been an issue in only a few cases to date.

Contractors who have performed work like that often performed under environmental restoration contracts have been found to be Potentially Responsible Parties (PRPs), as defined by CERCLA, and as a result of that work, they have been held liable for contribution to other PRPs. In only one case so far has an environmental restoration contractor actually been found solely liable for the cleanup costs pursuant to CERCLA. In this instance, a trucking company whose truck tipped over at a highway interchange while hauling waste away from a site has been required to pay the costs of a cleanup. While the court found the on-site contractor was also liable, it imposed the entire cost of the cleanup on the trucking company. The court found that the liability was divisible, and the trucking company was entirely and solely responsible for the release.

Six environmental restoration contractors—Reidel, O. H. Materials (OHM), Roy F. Weston, ENSR, HDR Engineering, and IT Corporation—are known to have claims pending against them in five separate litigations. In the case concerning IT Corp., IT initiated the litigation, and the claims have been made in the form of defenses. The claims asserted by the plaintiffs include both of the types discussed below—CERCLA-based and state law-based tort claims.

No contractor, either an "ordinary construction contractor" that has undertaken restoration-like activities, or an actual environmental restoration contractor, has been found liable for claims for damages or personal injury resulting from a release from a hazardous waste site. However, there is nothing in the law that intrinsically diminishes the viability of such claims. Courts have refused to dismiss them in several pending cases and have thus cleared the way for litigation to proceed.

The government contractor defense, which protects contractors from liability under state law for design defects in products they have manufactured for the United States, has been denied to two contractors involved in environmental cleanup. In the first case, a contractor that excavated and removed contaminated material was denied the defense because the court refused to extend the doctrine beyond its original context, production of goods for the government. In the second case, a management and operations contractor at a DOE site, accused of responsibility for a release of hazardous materials, attempted to set up the government contractor defense. The court found that because the releases alleged violated both state and federal law, there was no conflict between the two requiring that the contractor be immune in order to protect government immunity. No case has raised the defense in the context of a contractor that built and/or operates an on-site treatment facility.

The government agency defense is another defense that has been tried by contractors involved in environmental cleanup work. This defense protects contractors from liability if they are acting within the scope of their duties as agents of the government, and the government would have been immune from suit. One court has ruled, however, that environmental restoration contractors working at NPL sites or performing removal actions cannot use this defense because CERCLA § 119 provides EPA and other federal agencies with discretionary authority to indemnify these contractors. This demonstrated to the court that such contractors are independent, and not agents of the federal government who might receive immunity. No case has explored

whether the defense is still available to contractors employed by federal agencies to clean up non-NPL sites, where § 119 indemnification is not available (except for removal actions).

Strict liability in damage or injury claims under state law applies to activities that are found to be "ultrahazardous." Whether state law-based strict liability claims against DoD environmental response contractors will succeed depends on whether the specific actions in handling, transporting, and disposing of hazardous materials involved in the case are deemed to be an ultrahazardous activities. Courts have split on this point.

The Federal Tort Claims Act (FTCA) is a limited waiver of the government's normal immunity to suit. It allows suits against the government for damages to property and personal injury arising out of the negligence of government employees. The FTCA also includes some exceptions to that waiver, including the "discretionary function" exception. Under this exception, the government remains immune from damage claims based on "discretionary functions." The discretionary function exception requires that the government's action in question be based on making policy choices rather than following rules and regulations. Contractors are concerned that in cases where actions of both the contractor and the government caused the damage, the government will frequently be excused from liability under this exception, leaving the contractor to bear the liability alone. However, in three cases involving hazardous waste haulers, the courts found that the government should have followed relevant rules and regulations and did not, and thus could not claim the discretionary function exception. In a case where both the government and Shell Oil were responsible for property damage resulting from cleanup activities, the government's actions were ruled to be discretionary functions, so the government was dismissed as a defendant.

INTRODUCTION

Many contractors interested in obtaining environmental restoration contracts fear that they will be subject to claims for response costs or money damages as a result of their activities at hazardous waste sites. It is perceived that some of these claims will arise out of contractors' having changed and perhaps worsened site conditions or out of the malfunction of cleanup equipment and technologies. Perhaps of greater concern to contractors, because of the unknowns involved, is that they will be held to be "strictly, jointly and severally liable" for releases from the site, even though they are not at fault in the occurrence. "Strict liability" is liability without fault. CERCLA imposes strict liability for cleanup costs on almost anyone involved in sending waste to, owning, or operating a hazardous waste site, and it could extend to environmental restoration contractors. "Joint and several liability" in this context, means that anyone involved in disposing of or cleaning up waste at the site would be liable for the full amount of any damages to third parties, regardless of who—if anyone—was at fault. Sending one barrel of waste to a million-gallon disposal site could, in principle, expose the sender to the entire cost of cleaning up the site. Courts apply the concept of joint and several liability when two or more parties have contributed to the claimants' damages, but it is difficult to divide the responsibility among them. The claimant can sue any of the parties that were involved, and collect the entire amount of damages from it. That party, in turn can sue the other parties involved for "contribution" to the damages, but in the meantime the claimant has been paid.

The parties who contributed to the creation of a hazardous waste site have generally been held to have "strict, joint and several liability" for cleanup costs under CERCLA. Three recent Court of Appeals decisions, however, have permitted disposers at a site to show that their contribution to the damage was divisible from other contributions, thus relieving them of joint and several liability.

Many environmental restoration contractors have anticipated that the courts will also impose strict, joint, and several liability for damage claims. If that occurs, contractors are concerned that they may find themselves subject to strict, joint, and several liability for damages (especially if contamination migrates beyond site boundaries), immediate personal injuries, and adverse exposure-related health effects that may not appear for many years. Contractors are particularly concerned that under some circumstances, they could be liable for the entire cost, as no other party could be held liable or would be able to pay. Table 4-1 shows the types of claims, as well as the category of plaintiff most likely to assert each type of claim.

Table 4-1. Potential Liability of Environmental Restoration Contractors

Type of Plaintiff	Type of Claim					
	CERCLA Cost Recovery[1,*]	CERCLA Contribution*	Breach of Contract	Property Damage	Personal Injury/ Wrongful Death	Long-Tail Health Claims[2]
EPA (as federal government enforcer of CERCLA)	✔					
State and Local Governments[3]	✔			✔		
Other PRPs	✔	✔				
Those Contracting for the Services (e.g., DoD)	✔	✔	✔[4]	✔		
Site Workers					✔	✔
Private Citizens	✔		?[5]	✔[6]	✔	✔

[1]It should be noted that federal courts are deadlocked over whether attorneys' fees are recoverable response costs under CERCLA. See for example, *Stanton Road Associates v. Lohrey Enterprises*, 984 F.2d 1015, 1017-1020 (9th Cir. 1993) and *General Electric Co. v. Litton Indus. Automation Sys. Inc.*, 920 F. 2d 1415 (8th Cir. 1990) cert. denied 113 L. Ed. 2d 446, 111 S. Ct. 1390 (1991).

[2]While not enough time has passed for any of these claims to have actually been filed, several sets of private citizens have requested compensation for medical monitoring costs and emotional distress. Conceivably, plaintiffs could also seek compensation for increased risk of contracting a disease in the future and for the fear of such diseases.

[3]State and local governments may also seek to enforce state laws that are similar to Superfund.

[4]Prime contractors and their subcontractors may also get into disputes regarding contract performance. See for example, *Roy F. Weston, Inc. v. Halliburton NUS Environmental Corp. and Indiana Lumberman's Mutual Insurance Co.*, No. 91-1133 (E.D. Pa, 16 March 1993).

[5]It is conceivable, but unlikely, that private citizens could make out a claim related to the performance of the clean-up contract on third-party beneficiary theories.

[6]Property damages may be alleged by those who own land adjacent to a contaminated area or by those who purchase land, without knowing it has been contaminated or believing that it has cleaned up when it has not been.

*Environmental restoration contractors who are performing work at NPL sites, or performing removals at any site, qualify as Response Action Contractors (RACs), and under CERCLA §119, are immune from federal strict liability laws. All other environmental restoration contractors remain strictly liable under federal law.

Chapter 4: Contractor Liabilities

One hypothetical instance frequently mentioned would arise if the only other party responsible for a damage claim was a government agency. The government is normally immune from suit under the doctrine of "sovereign immunity." Congress can waive this immunity by statute. CERCLA is one of these waivers; DoD is open to suit for CERCLA cleanup costs by PRPs in the same way as anyone else. For damage claims resulting from government activities, however, Congress has passed the FTCA,[1] which allows suits against the federal government for negligence. The FTCA does not authorize suits based on strict liability, however, and it also bars suits where the government was exercising a "discretionary function."

Few claims have been made against environmental restoration contractors to date. Trade associations representing these contractors maintain that this is because contractor liabilities are more likely to be incurred during cleanup, and this phase of site remediation is just beginning. It is difficult to determine whether or not this assertion is true. Contractors have been conducting field investigations at hazardous waste sites for many years. Because these investigation activities also have the potential to change site conditions and because these site investigation contractors operate in the midst of significant uncertainties, it seems likely that some would have exacerbated site conditions and attracted the attention of plaintiffs. Also, there have been many removal actions and other interim "hands-on" actions taken during the site investigation phase that could have caused third-party damages, yet few suits have been filed.

The following discusses every case[2]—including some that have been filed but not resolved—that DoD was able to find, either as a result of its own research or from reports by others, that would seem to bear on the potential liability of environmental restoration contractors. Many of the cases do not involve environmental restoration contractors *per se*. They have been included because the contractors that were involved undertook activities similar to those that environmental restoration contractors undertake and were exposed to CERCLA or tort liability in the same fashion as an environmental restoration contractor would be. They help illuminate the issues and the reasons for the contracting community's concerns.

The following discussion categorizes claims into CERCLA- and state law-based (tort) claims. Cases are primarily discussed in the context of one or the other, but it should be realized that plaintiffs typically allege as many causes of action as their version of the facts will support. Thus, defendant contractors potentially face multiple types of claims in a single litigation.

CERCLA-BASED CLAIMS

Contractors performing environmental restoration work may find themselves subject to liability for cleanup costs under CERCLA on two bases: (1) a cost-recovery action brought by any person incurring response costs,[3] including the federal government, state and local governments, private citizens, and PRPs; or (2) a contribution action brought by another PRP.[4] While all plaintiffs must make out the same elements in order to demonstrate the liability of another party, the degree of liability differs between the two causes of action. In a cost-recovery action, responsible parties may be held strictly, jointly, and severally liable for the entire cost. In a contribution action, the court may allocate responsibility based on whatever equitable factors it finds to be relevant.[5] In order to affix CERCLA liability, the plaintiff must show that (1) the defendant falls within one of four classes of persons: owner or operator; former owner or operator at the time of disposal; persons who arranged for disposal of the hazardous substances, known as generators; or transporters who selected the disposal facility; (2) the site in question is a "facility" as defined by CERCLA; (3) there was a release of hazardous substances; and (4) the release caused response costs to be incurred. Strict liability applies; it is not necessary to show that the party was negligent in its actions or otherwise caused the release of hazardous materials. It need only be in one of the four classes.

CERCLA § 119(a) does afford some relief to contractors conducting remediation actions on NPL sites, and removal actions. They can be held liable for response costs under CERCLA only if the actions leading to the costs were negligent (careless or unprofessional); grossly negligent (often translated as reckless or indifferent to the consequences), or constituted intentional misconduct. They are not subject to strict liability. While this leaves many DoD environmental response contractors still exposed to strict liability for response costs (those not working on NPL sites or performing removal actions), it considerably ameliorates the perceived problem. When a party seeks to recover response costs based on strict liability (no negligence), a contractor covered by Section 119(a) also could not be held jointly and severally liable. Joint and several liability with respect to those contractors would

be limited to CERCLA claims based on negligent performance by the contractor and other parties.

Joint and several liability under CERCLA exists only with respect to the enforcement agency or injured private party. The contributors to the damage, which for CERCLA purposes could be anyone in the four classes, have a right to sue each other for "contribution." In this second lawsuit, each party has to pay a share based on his or her degree of responsibility. This share could be assessed based on the amount of chemicals sent to a site, negligent actions in cleanup work, fraud in record keeping, or a variety of other site-specific factors. While the possibility of obtaining contribution provides some relief from the specter of joint and several liability, the legal costs of securing it are extremely high and will not necessarily be reimbursed under a government contract. As we will see later, a trend is developing for the courts to limit the application of joint and several liability in cost-recovery cases. First, however, we will look at the reported cases related to the potential liability of environmental restoration contractors.

Cases Involving Environmental Restoration Contractors

Environmental Transp. Sys., Inc. (ETS) v. ENSCO, Inc.[6] specifically addresses the CERCLA liability of environmental restoration contractors, in this instance both a disposal contractor and a transporter. Northern States Power Company (NSP) contracted with ENSCO to dispose of obsolete transformers filled with polychlorinated biphenyl (PCB)-contaminated oil at an ENSCO facility offsite. The PCBs were spilled when a subcontractor's truck overturned en route to the prime contractor's disposal facility. The subcontractor trucking company, ETS, sought contribution, from the prime contractor, ENSCO, and the original generator of the PCB waste, NSP, to cover the cost of cleaning up the spill. In applying the four-part liability test of CERCLA, the District Court found, and the 7th Circuit affirmed, that both ENSCO and NSP were subject to cleanup liability under CERCLA. However, after evaluating the equities involved, the courts also found that neither ENSCO or NSP should be required to contribute to the cost of cleaning up the PCB spill, because ETS was solely responsible for the spill.

The District Court for the Northern District of Illinois recently declined to dismiss CERCLA liability claims brought by Quadion Corporation against its own cleanup contractors, OHM and HDR Engineering, Inc., for exacerbating contamination at a hazardous waste site.[7] It relied on *Kaiser Aluminum v. Catellus*, discussed below, a case in which an ordinary construction contractor was held liable for CERCLA contribution based on its actions in moving soil that was later discovered to be contaminated. Quadion alleged that both contractors were operators in that they controlled the activities in which additional contamination took place. While the court did not decide the question, it did note that control in this instance was even clearer than in *Kaiser*. There, the contractor only inadvertently handled contaminated soil, while in *Quadion*, the contractors had been specifically hired to deal with hazardous materials.

In *Danella Southwest, Inc. v. Southwestern Bell Tel. Co.*,[8] a generator PRP sought contribution from its contractor, which had excavated and transported soils contaminated with dioxin, on the basis that the contractor had contractually indemnified the PRP. In assessing the applicability of the indemnification clause in their contract, the court found that the parties could not have intended for CERCLA liability to be embraced by it because neither party knew that the soil was contaminated with dioxin. This case illustrates the necessity of accurate draftsmanship of indemnification clauses, but is otherwise included only because it is one of the few reported cases involving environmental restoration contractors.

A few other CERCLA cases naming environmental restoration contractors have been filed, but no decisions have been handed down as yet. In *Atlantic Richfield Co. (ARCO) v. Torger L. Oaas*,[9] ARCO filed a complaint in the District Court of Montana seeking CERCLA cost recovery and CERCLA and Montana hazardous waste law (CECRA[10]) contribution, including that associated with natural resource damage claims, from two EPA contractors. Reidel Environmental Services had performed as an Emergency Response Cleanup Services (ERCS) contractor and Roy F. Weston provided the Technical Assistance Team during a removal action at the Montana Pole and Treating Plant Superfund site. With regard to the actions of Reidel and Weston, ARCO avers that the oil/pentachlorophenol (PCP) intercept and filtration system designed, installed, and operated by the contractors has itself become a "facility" and that both contractors are liable persons within the meaning of CERCLA.

In *Dumes v. Houston Lighting & Power Co.*,[11] a group of homeowners sued to recover past and future response costs from the PRPs at the Industrial Metals

and Industrial Roads site and from the site remediation contractor, ENSR.[12] The plaintiffs have alleged that ENSR is liable under CERCLA as a "transporter" of lead onto the plaintiffs' property.

Cases Involving Construction Contractors

Kaiser Aluminum & Chemical Corp. v. Catellus Development Corp.[13] is a CERCLA contribution action against an ordinary construction contractor. While the contractor was not an environmental restoration contractor, it undertook the same types of actions—soil moving—that an environmental restoration contractor might undertake. This case is frequently referred to by the contracting community as an example of the wide-ranging imposition of liability that they face. Catellus had sold a parcel of land to the city of Richmond, California. Richmond hired Ferry to excavate and grade a portion of the land, which subsequently proved to contain soil contaminated with hazardous chemicals. In doing so, Ferry spread some of the contaminated soil over other parts of the property. Richmond sued Catellus to recover part of the cost of removing the contaminated soil, and Catellus, in turn, filed a third-party complaint against Ferry for contribution under CERCLA, alleging that Ferry had exacerbated the extent of contamination by spreading the contaminated soil over uncontaminated areas of the property.

In refusing to dismiss Catellus' claims, the Ninth Circuit cleared the way for Ferry to be found an "operator" within the meaning of CERCLA because Ferry had the authority to control the source of contamination at the time the hazardous substances were released into the environment.[14] The court also cleared the way for a finding that Ferry had "disposed of" hazardous substances as that term is defined in CERCLA.[15] Relying on *Tanglewood East Homeowners v. Charles-Thomas, Inc.*,[16] the court concluded that disposal should not be limited to the initial introduction of hazardous substances onto the property, but that it should also include the dispersal of contaminated soil during excavation and grading. The Ninth Circuit additionally found that Ferry could be liable as a "transporter" in that if, as alleged by Catellus, Ferry's excavation and relocation of soils met the CERCLA definition of transportation: "the movement of a hazardous substance by any mode...."[17] In determining whether Ferry transported the soil "to...sites selected by such person,"[18] the court found that it would not matter if Ferry had transported the soils over a property boundary.

The Ninth Circuit took care to demonstrate that its decision in *Catellus* was consistent with the Seventh Circuit's decision in *Edward Hines Lumber Co. v. Vulcan Materials Co.*,[19] upon which Ferry relied. In *Hines*, a contractor designed and built a wood treatment plant. After the plant was completed, the owner began processing wood for resale, and hazardous substances were released onto the plant site. The owner was forced to clean up the site and then sued the contractor for contribution. The Seventh Circuit dismissed the suit against the contractor because the contractor had no authority to control the day-to-day operation of the plant after it was built and during which the hazardous substances were released. Like the Seventh Circuit, the Ninth Circuit predicated Ferry's potential liability on its authority to control. Thus, although the rule articulated in both cases is the same, the facts resulted in different outcomes. In *Hines*, the rule led to the dismissal of the cause of action based on the facts, while in *Catellus*, it opened a way for a finding of liability if the plaintiff can ultimately make out the facts it alleges.

Kaiser is frequently cited by the contracting community as an example of the wide-ranging imposition of liability that they face. While it did not involve an environmental restoration contractor, it was cited by the court in *Quadion* as authority for the liability of remediation contractors in similar circumstances.

In Brookfield-North Riverside Water Comm'n v. Martin Oil Marketing Ltd.,[20] the District Court reached a different outcome than the Ninth Circuit did in *Kaiser*, even though the circumstances were similar. As in *Kaiser*, the contractor—Abbott Contractors, Inc.—was not an environmental restoration contractor but rather a construction contractor. It had unknowingly installed a water main through soil that had been contaminated by hazardous substances from a nearby leaking underground storage tank located on Martin Oil's property. The court found that although the water main was a "facility" within the meaning of CERCLA, Abbott was not an "operator" because Abbott had not introduced any hazardous substances onto the premises. All the wastes found on the construction site originated from Martin Oil's service station.

Joint and Several Liability Reexamined

Three Court of Appeals decisions during 1992 and 1993 in cases involving CERCLA PRPs have cast doubt on the assumption that all PRPs will routinely be held jointly and severally liable for all damages and cleanup

costs, regardless of fault. In a 28 September 1993 case, In *re Bell Petroleum Services*[21] the Fifth Circuit specifically stated that application of joint and several liability "was not mandatory" among PRPs, "and should be imposed only in extraordinary circumstances." In two cases involving similar facts but different disposal sites, the Second[22] and Third[23] Circuits both afforded Alcan Aluminum Corp., the disposer, the opportunity to prove that its waste did not rise above the background level in nature of the alleged contaminants, and therefore was not "hazardous waste," even though it was a liquid poured into a chemical stew of wastes in old mine shafts.

None of these cases involved an environmental restoration contractor. In *Alcan*, enforcement authorities were seeking to recover response costs from a disposer, and in *Bell*, EPA and a PRP were litigating their respective liabilities. It seems likely, however, that a contractor would have a better opportunity to distinguish its share of the responsibility, if any, from that of the original contributors. Therefore, if this trend continues, one of the concerns expressed by contractors would be mitigated considerably. They would not necessarily become the "deep pocket"—the only party with the financial resources to pay—for all costs of a cleanup just because they were on site and within one of CERCLA's four classes. Instead, they would have an opportunity to prove in a cost-recovery action that they did not contribute to the release complained of, or that they had only a divisible share of the responsibility.

The "deep pocket" problem, potentially a serious one at a private site if a number of small PRPs of uncertain financial strength are involved, is much less important to a contractor when DoD is a PRP. DoD would be at least as attractive a target as a contractor, based on ability to pay. A contractor could still run up significant legal defense costs, which may or may not be reimbursed by DoD, but is unlikely to be exposed to full cost recovery based solely on strict, joint, and several liability.

STATE LAW-BASED TORT CLAIMS

Environmental remediation contractors may also be subject to a variety of claims for damage to property or personal injury based on state law. To date, these claims have been based on negligence, trespass, nuisance, and strict liability for ultrahazardous activities. Claims for loss of value of property and personal injury must be pursued in actions in "tort." Whether brought in state or federal courts, these are based on state law, normally of the state where the release leading to the claim occurred. As a result, standard national rules are difficult to derive. A valid claim in one state might be dismissed without a trial in another, based solely on the difference in state law.

Claims Based on Fault

Turning to the reported negligence cases involving environmental response contractors, in *Shockley v. Hoechst Celanese Corp. and Aqua-Tech Environmental, Inc.*,[24] a group of real estate developers purchased a parcel of land adjacent to a Hoescht parking lot with the intent of creating a residential subdivision. During the 1970s, the parking lot had been the site of Groce Labs, predecessor to Aqua-Tech Environmental, a contractor that received and ostensibly treated Hoescht chemical wastes. After title passed, Hoechst informed the developers that the groundwater under the parking lot was contaminated with hazardous chemicals as a result of the Groce operations, and subsequent testing confirmed that the wastes had migrated onto the developers' adjacent property. After a jury trial, Hoescht and Aqua-Tech, the disposal contractor's successor, were found liable to the developers for damages in the amount of $250,000 based on South Carolina claims of trespass, nuisance, and negligence.[25]

The relationship between Hoescht and Groce Labs during the 1970s was an unusual one, so the case is not a solid precedent for contractor liability. Mr. Groce was a chemist employed by Hoescht at the plant from the late 1960s until 1974. In 1971, while still employed by Hoescht, he opened Groce Labs, a hazardous chemical reclamation facility, directly across the street from the Hoescht plant. In 1977, he sold the Groce Labs site to Hoescht, which then paved it and turned it into a parking lot. Mr. Groce was technically an environmental restoration contractor (owner/operator of the disposal site), but his relationship with Hoechst does not appear to have been an arms-length one.

In *Bell v. Sediment Removers, Inc.*,[26] Bell and Reeves owned adjacent properties. A four-acre borrow pit traversed a common boundary. In 1975, Firestone contracted with Sediment Removers to dispose of nonhazardous waste. Sediment Removers, in turn, contracted with Reeves for transportation of the material to the pit co-owned by Bell and Reeves. Dumping was on Reeves' side of the pit but without Bell's permission. An undetermined amount of waste settled on Bell's side of the pit before he obtained an injunction against the disposal. Bell subsequently brought an action in trespass

against Firestone, Sediment Removers, and Reeves.

The trial court dismissed Firestone and found Reeves and Bell solidarily liable for $12,500 in damages. The Louisiana Court of Appeals overturned this ruling. Although Bell had proved a technical trespass—the unlawful physical invasion of his property—he failed to prove, by a preponderance of evidence, that the property was damaged. The appeals court found that the trial court had made its award because of "improper dumping," that the award was penal in nature, and therefore improper in a tort action.

In *ARCO v. Oaas*,[27] ARCO has asserted a negligence claim, in addition to CERCLA claims, against Reidel and Weston. ARCO alleged that the contractors owed a duty to the PRPs at the site to perform in a non-negligent way and that both contractors acted negligently or with gross negligence in their design, installation, and operation, and in that the system has exacerbated and spread contamination at and from the site.

In *Dumes v. Houston Lighting & Power Co.*,[28] the homeowners living near the Industrial Metals site have also made claims of this sort against ENSR, stating that ENSR had a duty to complete closure of the site in a manner such that contaminated substances were not transported to the homeowners' property, and that ENSR breached this duty when it caused additional lead-contaminated water to run off and lead dust to accumulate on plaintiffs' property. In addition to loss of property value, the plaintiffs are seeking damages for various chronic ailments and extreme mental anguish.

In *Quadion*,[29] the court did bar the negligence claims of Quadion, the construction contractor, against HDR (the designer), but only because Quadion alleged economic losses (the cost it expended in cleaning up the PCBs), which are not recoverable in a tort action in Illinois,[30] instead of personal injury or property damage.

Strict Liability Cases Against Environmental Restoration Contractors

The law in most states makes a party who conducts an "abnormally dangerous" or "ultrahazardous"[31] activity strictly liable for damages, regardless of fault. Hazardous waste cleanups could be, and indeed have been, viewed as more dangerous than ordinary activities. Whether a plaintiff can sustain a strict liability claim is highly variable and dependent on state law. Several courts have dismissed these claims on the basis that transportation and disposal of hazardous substances are not ultrahazardous activities.[32] However, in *New York v. Shore Realty Corp.*,[33] the Second Circuit concluded that a New York court could find the disposal of hazardous waste an inherently dangerous activity and could impose strict liability. The Eleventh Circuit reached a similar conclusion in applying Florida law in *Dickerson Inc. v. United States*.[34] Dickerson was a paving company that used waste oil to heat its asphalt. It received, unknowingly, oil contaminated with PCBs from its supplier, which had in turn obtained them through a government waste disposal contract. The court pointed out that "Scientists have found PCB concentrations far below those involved in this case to cause cancer, decreased fertility, still births, and birth defects in test animals...The EPA has noted the 'well-documented human health and environmental hazard of PCB exposure' and the 'potential hazard of PCB exposure posed by transportation of PCBs.'" The court concluded that this made transportation and disposal "inherently dangerous." Perhaps the most straightforward case of this type is *Daigle v. Shell Oil Co.*[35] The Army dumped chemical warfare liquid waste into a 93-acre pond, and also allowed Shell Oil Company to dump herbicide and pesticide wastes in it. The resulting mixture leaked into the environment for years. In a claim for damages and injuries to health from residents of a nearby trailer park, the defendants argued on the basis of a Colorado case involving a 15-gallon tin of caustic liquid that filling a 93-acre pond with hazardous chemicals was not an "ultrahazardous activity" under Colorado law. The Tenth Circuit rejected the analogy, rejecting "the huge logic leap from a 15-gallon container...to the ninety-three acre lake in this case." It found "no reason why the Colorado courts would not apply the Restatement rule [defining abnormally dangerous activities] to a new situation such as the ninety-three acre toxic lake at Basin F."

The possibility exists, therefore, that in a given case the court will find environmental response activities "ultrahazardous" and impose strict liability for tort claims on the contractor regardless of fault. Unlike CERCLA, where strict liability is established by law, strict liability for environmental restoration work has not yet been adopted as a general rule, and may vary state by state for some years.

Special Defenses for Government Contractors

Amtreco, Inc. v. O.H. Materials, Inc.[36] is an interesting and important case in that it gives some

indication of the relationship between CERCLA § 119(c), which permits indemnification of RACs,[37] and two defenses normally available to government contractors under the right circumstances. Amtreco and Dickerson, in response to a CERCLA cost-recovery action filed against them by EPA, filed a separate suit against OHM, EPA's emergency response contractor, and certain EPA employees. Specifically, Amtreco alleged state-based tort claims for conversion, property damage, and false swearing.[38]

The court dismissed the claims against the EPA employees, but not against OHM. Additionally, it found that OHM could sustain neither the "government contractor" nor the "government agency" defense. The government contractor defense, which was adopted by the Supreme Court in 1988,[39] protects contractors from liability under state law for design defects in products they have manufactured for the United States, but based on government specifications. The court disallowed this defense on the basis that there was no comparison between a claim based upon a product design defect and a claim based on intentional misconduct. It declined to extend the defense beyond the specific facts in the Boyle case to include service contracts.

Although the *Amtreco* court did find that the EPA/OHM emergency removal contract was a government performance contract, it also found that CERCLA § 119 contemplates that all RACs are independently liable for their negligent or other tortious behavior. That is because EPA, at its option, may or may not assume the contractors' liability via indemnification. Additionally, the court found that the terms of the contract—the fact that EPA required OHM to obtain general liability insurance and that it would otherwise indemnify OHM against liability arising from its negligence and resulting in release of hazardous substances—indicated that the parties did not consider OHM to be an EPA agent. If the Amtreco court is right, CERCLA § 119 has put RACs working at NPL sites—whether they are indemnified or not—in the position of being unable to plead the government agency defense because they are by operation of law deemed to be independent contractors, rather than government agents.

Crawford v. National Lead Co.[40] is another example of a failed government contractor defense. In this case, residents near Fernald Materials Production Center sued DoE's Management and Operations (M&O) contractor for damages resulting from release of radioactive and other harmful materials. Plaintiffs pleaded both strict liability and nuisance claims, and sought damages for emotional distress and diminished property values. The court rejected the government contractor defense. It pointed to the "threshold requirement" in *Boyle*, that application permitting a government contractor to be sued must interfere with federal interests or policies. In *Boyle*, this interference was the effective loss of the government's immunity to suits by military personnel for injuries resulting from their official duties that would occur if its contractor were forced to pay for the same injuries. The Crawford court noted that the admitted discharges at Fernald violated federal as well as state laws, so there could be no conflict with federal interests. This case was ultimately settled for $60 million.[41] While National Lead was an M&O contractor, the same logic would seem to apply to an environmental restoration contractor.

The other rejected defense, the "government agency defense," does apply to government performance contracts. This defense is much older and not often used, since government agencies generally make it clear that contractors are not "agents" of the government. The defense has, however, been endorsed by the Supreme Court.[42] In *Shaw v. Grumman Aerospace Corp.*,[43] the Eleventh Circuit outlined a three-step inquiry in determining whether the government agency defense is satisfied. First, a court is to determine if the government itself could be sued in the given situation. If not, a court is then to invoke the law of principal and agent to determine whether the contractor actually acted as an agent of the government. Finally, if a court determines the contractor was acting as an agent, it is then to determine if the contractor acted within the scope and course of its duties.

Cases Involving Both the Government and a Contractor

The FTCA[44] is a limited waiver of the government's normal immunity to suit. It allows suits against the government for damages to property and personal injury arising out of the negligence of government employees. It was passed because Congress recognized that in an organization as large as the federal government there would inevitably be careless acts that would injure members of the public. For example, the federal government owns tens of thousands of automobiles; some of them collide with private cars under circumstances where the driver, if a private citizen, would have been liable to pay damages. Congress did not want the victims of such ordinary and inevitable

accidents to go uncompensated. Neither did it wish to become bogged down with thousands of special "private relief bills" that would provide compensation by statute. It chose to waive sovereign immunity for these routine cases and let them be resolved through the normal operation of the court system.

The FTCA requires an act to be negligent for the government to be liable. Therefore, the government is not subject to "strict liability," where the mere fact of engaging in an "extremely dangerous" activity would expose the government to liability even if acted properly. The government inevitably engages in dangerous activities, from ammunition manufacturing and testing to high-speed chases of fleeing felons. Strict liability could open the Treasury to claims of monumental proportions, such as those resulting from the explosion of a shipload of hazardous cargo.[45] Congress, in effect, reserved for itself the right to decide to what extent, if any, the government would compensate victims of a disaster that resulted from a government activity, but without any fault. It could, if it so chose, pass relief legislation specific to that incident.

Congress was also concerned that disputes over policy decisions should not end up as lawsuits against the government for damages. The FTCA does not permit suits based on "discretionary functions," even if the discretion is abused. "Discretionary function" is not shorthand for "any action involving a choice between alternatives," as some contractors fear. It only includes policy choices where there is no specific rule to follow. The Supreme Court has recently stated in *U.S. v. Gaubert*[46] that "the purpose of the [discretionary function] exception is to prevent judicial 'second guessing' of legislative and administrative decisions grounded in *social, economic, and political policy* through the medium of an action in tort...when properly construed, the exception 'protects only governmental actions and decisions based on considerations of public policy...'" (emphasis supplied).[47] An air traffic controller, for example, is exercising "discretion" when he or she directs a plane to turn left. The decision, however, is based on weather, local and regional air traffic, and perhaps the flying characteristics of the plane, none of which involve public policy issues. The controller's negligence could be the basis for a suit against the government. A decision to locate or close an air traffic control facility at that location would be quite different. A suit for damages because there was no tower at the local airport is likely to be dismissed because it involves a discretionary function. The Supreme Court in *Gaubert* also pointed out that if there is a law or regulation mandating specific conduct, there is no discretion. The rule has to be followed, and the function itself is not discretionary.

Both the strict liability and discretionary function exceptions are sometimes mischaracterized as special immunities on the part of the government. However, this is not the case. The government is normally immune from suit; it is the waiver of that immunity in the FTCA that is special. Strict liability and discretionary function are "exceptions" to that waiver. Another situation sometimes mischaracterized is the "independent contractor exception." The FTCA only allows suits against the government for the negligent acts of government employees. It explicitly provides that the government may not be sued for the torts of independent contractors.[48] Each of these "exceptions" to the FTCA can be, and frequently is, pleaded by the government as a defense to liability in a lawsuit. Many proponents of indemnification have expressed a concern that, to the extent that environmental restoration contractors are found to be independent contractors, the federal government will be immune to state law-based claims under the "independent contractor exemption." In fact, the government never agreed to be sued for contractor actions, and government lawyers are obliged to call the court's attention to this fact.

The government has had mixed success in pleading discretionary function as a defense in cases involving hazardous waste haulers. In *Dickerson v. United States*,[49] the Eleventh Circuit ruled that the federal policies, statutes, and regulations on control of hazardous waste rendered the exception unavailable. The government had argued that in selecting the contractor that delivered hazardous waste to the waste oil supplier of Dickerson, an asphalt paver, it was exercising a discretionary function. The court found that both statutes and the internal rules of the Defense Supply Agency had been violated. In particular, the contracting officer had made no investigation of the availability of the disposal site offered by the contractor and had failed to check up on performance of not one but two contracts. There being no discretion to violate laws or regulations, the government remained a defendant. In *Smalls v. EPA*,[50] EPA had contracted with a transporter to haul waste from Superfund sites in Pennsylvania to a properly licensed landfill in Alabama. Instead, the waste was dumped at nearby property in Pennsylvania. The adjacent residents sued both EPA and the contractor for damages. The District dismissed EPA as a defendant,

holding that selecting the contractor involves the exercise of administrative discretion and judgment, but the Third Circuit reversed.[51] *Woodman v. United States*[52] was decided after *Gaubert*, and with specific reliance on it. In 1968, the Navy contracted with a waste hauler to remove dumpsters and dispose of them. The disposal site eventually leaked, and the adjacent landowners sued. The contract provided that the trash to be removed would consist essentially of household and shop waste, but would not include acids, flammable liquids, or explosives. The court found that the Navy had a mandatory duty not to place the contraband materials in the dumpsters. Dumping them, as it had, violated the contract and base regulations. Thus, even if the contractor selection was discretionary (the court did not rule on that point), the violation of the Navy's plain duties precluded application of the discretionary function exception.

The government has been successful in using the discretionary function exception in a case involving the selection and conduct of an environmental restoration remedy. The 10th Circuit dismissed the government from *Daigle v. Shell Oil*[53] on the basis of the discretionary function exception. The plaintiffs, residents of a neighboring trailer park, sought damages on the grounds that the government had negligently executed the Basin F cleanup, and had failed to warn them that the method used would result in toxic fumes blowing over their residences. The Court found that both giving Basin F high priority and selecting a remedy involved policy choices. The plaintiffs had failed in their pleadings to point to any specific laws or regulations that had been violated in the process. Since the actions of the complaint were discretionary functions, allegations that they were badly done did not state a claim against the government. Shell was not dismissed, however. It remained a defendant against the tort-based claims, and subsequently settled out of court with the plaintiffs. It is not clear how applicable this case would be to a remediation contractor. EBASCO, the contractor, was not sued; only the two PRPs who caused the Basin F problem in the first place were named as defendants.

There have been at least two hazardous waste cases involving government agencies where strict liability was alleged as the basis for a claim. In *Daigle*, the plaintiffs recognized that the Army could not be sued under strict liability, so they sued only Shell on the strict liability count. For *New York v. Shore Realty Corp.*,[54] the owners of a hazardous waste site sued 95 purported generators, including the Coast Guard and the Veteran's Administration, for contribution. While the Court recognized that the agencies were not liable under strict liability, it found them potentially so under other provisions of New York law.

In principle, contractors' concerns about the government invoking the discretionary function or strict liability exception in a case where the environmental restoration contractor would be the remaining liable party are not entirely ill-founded, but they have not actually happened in a case involving such a contractor. However, such cases are highly fact-specific, and it is possible that the contractors' hypothetical situation could come about.

ENDNOTES:

[1] 28 U.S.C.A. § 2671-80 (West 1965 & Supp.1993).

[2] First-party breach of contract cases are not discussed here since indemnification does not apply to these liabilities.

[3] 42 U.S.C A. § 9607(a) (West 1983 & Supp. 1993).

[4] 42 U.S.C.A. § 9613 (f) (1) (West 1983 & Supp. 1993). For a discussion of whether the EPA can be held liable for contribution as a result of a less than successful cleanup, *see U.S. v. Western Processing Co.*, 761 F. Supp. 725 (W.D. Wash. 1991).

[5] *See A&F Materials Co., Inc.*, 578 F. Supp. 1249 (S.D. Ill. 1984)—pertinent factors in this case include (1) the ability of the parties to demonstrate that their contribution to a release can be distinguished from the contributions of other parties, (2) amount of hazardous waste involved, (3) degree of toxicity, (4) degree of involvement, (5) degree of care exercised, (6) degree of cooperation with regulatory officials; *United States v. Chem-Dyne Corp.*, 572 F. Supp. 802 (S.D. Ohio 1983); *Barton Solvents Inc. v. Southwest Petro-Chem Inc.*, D.C. Kan, No. 91 2382-GTV (where the court held that a PRP may file a cost-recovery action under CERCLA and defendants may be held jointly and severally liable).

[6] 763 F. Supp. 384 (C.D. Ill. 1991), *aff'd*, 969 F.2d 503 (7th Cir. 1992).

[7] *Ganton Technologies, Inc. v. Quadion Corp.*, No. 89 C 6869, 89 C 3586 (Consolidated) (N.D. Ill. 4 October 1993).

[8] 775 F. Supp. 1227 (E.D. Mo. 1991), *aff'd*, 978 F.2d 1263 (1992).

[9] No. CV-90-75-BU-PGH (D.C. Mont. 1991).

[10] Montana Comprehensive Environmental Cleanup and Responsibility Act, MONT. CODE ANN. §§ 75-10-701-724 (1991).

[11] No. C-90-330 (S.C. Tex. pending).

[12] The EPA was also named as a defendant, but the plaintiffs did not request service at the time the complaint was filed.

ENDNOTES (Continued)

[13] 976 F.2d 1338 (9th Cir. 1992).

[14] *See Nurad, Inc. v. Hooper & Sons Co.*, 966 F.2d 837, 842 (4th Cir. 1992), *cert. denied*, 113 S.Ct. 377 (1992); *CPC Int'l, Inc. v. Aerojet-General Corp.*, 731 F. Supp. 783, 788 (W.D. Mich. 1989).

[15] 42 U.S.C.A. §9607(a)(2) (West 1983 & Supp. 1993).

[16] 849 F.2d 1568 (5th Cir. 1988).

[17] 42 U.S.C.A. § 9601 (26) (West 1983 & Supp. 1993).

[18] 42 U.S.C.A. § 9607 (a)(4) (West 1983 & Supp. 1993).

[19] 861 F.2d 155 (7th Cir. 1988).

[20] No. 90 C 5884 (N.D. Ill. 12 March 1992).

[21] *In re Bell Petroleum Services*, No. 91-8080 (5th Cir. filed 28 September 1993).

[22] *United States and State of New York v. Alcan Aluminum Corp.*, 964 F.2d 711 (2nd Cir. 1993).

[23] *United States v. Alcan Aluminum Corp.*, 964 F.2d 252 (3rd Cir. 1992).

[24] *Shockley v. Hoechst Celanese Corp.*, 996 F.2d 1212 (4th Cir. 1993); *See also Shockley v. Hoechst Celanese Corp.*, 793 F. Supp. 670 (D S.C. 1992), *aff'd in part, rev'd in part*, 996 F.2d 1212 (1993).

[25] The developers also filed a CERCLA claim, but dismissed it after they prevailed on the state claims.

[26] 479 So. 2d 1078 (La. App. 1985).

[27] No. CV-90-75-BU-PGH (D.C. Mont. 1991).

[28] No. C-90-330 (S.C. Tex. pending).

[29] *Ganton Technologies, Inc. v. Quadion Corp.*, No. 89 C 6869, 89 C 3586 (Consolidated) (N.D. Ill. 4 October 1993).

[30] This is true in many jurisdictions.

ENDNOTES (Continued)

[31]"Ultrahazardous activity" is the traditional common law basis for strict liability, which the *Restatement of Torts* (2nd) replaced with "abnormally dangerous." They are equivalent. *Daigle v. Shell Oil Co*, 972 F.2d 1527 (10th Cir. 1992).

[32]*See Ganton Technologies, Inc. v. Quadion Corp.*, No. 89 C 6869, 89 C 3586 (Consolidated) (N.D. Ill. October 4, 1993); *Indiana Harbor Belt R. Co. v. American Cyanamid Co.*, 916 F.2d 1174 (7th Cir. 1990); *City of Bloomingdale, Ind. v. Westinghouse Elec. Corp.*, 891 F.2d 611, 616 n. 7 (7th Cir. 1989); *Shockley v. Hoechst Celanese Corp.*, 996 F.2d 1212 (4th Cir. 1993).

[33]759 F.2d 1032, 1052 (2d Cir. 1985).

[34]875 F. 2d 1577 (11th Cir. 1989).

[35]972 F.2d 1527 (10th Cir. 1992).

[36]802 F. Supp. 443 (M.D. Ga. 1992).

[37]42 U.S.C.A. § 9619(c) (West 1983 & Supp. 1993).

[38]This case was in federal court because plaintiffs also alleged federal claims relating to RICO violations, equal protection, and due process. They did not allege any CERCLA-based claims.

[39]*Boyle v. United Technologies Corp.*, 487 U.S. 500 (1988). To make out this defense, contractors must show at the outset that the application of state tort law would conflict with federal interests or policies, and that (1) the U.S. approved reasonably precise specifications for the equipment being purchased; (2) the equipment conformed to those specifications; and (3) the supplier warned the United States about the dangers of the equipment that were known to the supplier, but were not known to the United States.

[40]784 F. Supp. 439 (S.D. Ohio 1989).

[41]A similar, but as yet undecided, case has been filed by residents near DoE's Mound facility (*Stepp v. Monsanto Research Corp.* (No. C-3-91-468 [S.C. Ohio pending]). Plaintiffs are alleging negligence, strict liability, nuisance, trespass, and CERCLA violations.

ENDNOTES (Continued)

[42]In *Yearsley v. W.A. Ross Constr. Co.*, 309 U.S. 18 (1940), a contractor built dikes upon the Missouri River pursuant to a government contract, with the result that the petitioner's land was greatly eroded away. All work done by the contractor was authorized and supervised by the United States, and the work was performed pursuant to an Act of Congress. The Supreme Court held that if the authority to carry out the project has been validly conferred by Congress upon the federal government, then the contractor cannot be liable for executing the government's will. An agent, acting on behalf of the government, is only liable for his conduct when he exceeds his authority or the authority was not validly conferred.

[43]778 F.2d 736 (11th Cir. 1985), *cert. denied*, 487 U.S. 1233 (1988), *reh'g denied*, 487 U.S. 1250.

[44]28 U.S.C.A. § 2671-80 (West 1965 & Supp.1993).

[45]*See Dalehite v. United States*, 346 U.S. 15, 45.

[46]*U.S. v. Gaubert*, 499 U.S. 315 (1991).

[47]*Gaubert*, 111 S. Ct. 1267, 1273-74 (1991).

[48]28 U.S.C.A. § 2671 (West 1965 & Supp. 1993). *See Logue v. United States*, 412 U.S. 521 (1973).

[49]875 F. 2d 1577 (11th Cir. 1989).

[50]27 E.R.C. 1561 (M.D. Pa 1988).

[51]861 F.2d 60 (3rd Cir. 1988).

[52]764 F. Supp. 1455 (M.D. Fl. 1991).

[53]972 F.2d 1527 (10th Cir. 1992).

[54]759 F.2d 1032, 1052 (2d Cir. 1985).

Chapter 5: Indemnification Practices
Response to § 332, Paragraph (5)

Paragraph (5): The type of indemnification, if any, currently provided to environmental restoration contractors by Federal agencies, by State agencies, and by private entities at sites other than installations and sites referred to in paragraph (1).

SYNOPSIS

Most federal agencies do not regularly offer statutory indemnification to environmental restoration contractors. The Coast Guard is required by their Environmental Compliance and Restoration Authorization to offer indemnification using CERCLA § 119 authority to environmental restoration contractors performing work on NPL sites or performing removal actions. However, no qualified contractor has requested indemnification.

State practices vary widely. Ten states have passed indemnification authorities to cover environmental restoration contractors, but only eight states have used these authorities. New Jersey had an indemnification statute in place from 1986 until 1990, when it expired. A new indemnification authority was passed in 1992. New Jersey did not observe a decrease in competition after the original authority expired and has never used the new authority.

Fourteen states provide immunity rather than indemnification to environmental restoration contractors. This protects the contractor without incurring any additional state liabilities. However, as a result, an injured party may not have any way to be compensated for damages.

Sixteen states require environmental restoration contractors to indemnify the state against liability from the contractor's actions. Forty-one states prohibit indemnification of certain types of contractors in an effort to ensure competent contractor performance and design work. However, it is unlikely that these state statutes would affect federal indemnification of contractors since federal contracting is controlled by federal law.

It is difficult to determine conclusively the indemnification practices of private entities. Anecdotal evidence exists that suggests that the practices vary widely, from offering comprehensive indemnification to refusing to consider indemnification under any circumstances. None of the 17 respondents to DoD's survey of PRP practices provided broad indemnification coverage. Some provided very limited coverage, others provided coverage reluctantly on a case-by-case basis, and still others refused to indemnify under any circumstances. In addition, most of the responding PRPs require the contractor to indemnify them.

FEDERAL AGENCIES

EPA is the only federal agency that has established a written policy regarding indemnification of environmental restoration contractors. In general, most agencies, including EPA, do not offer statutory indemnification to environmental restoration contractors although there have been some exceptions that are discussed below and in Chapter 7.

Department of Defense

DoD generally does not provide indemnification for environmental restoration contractors. DoD did provide limited indemnification during the 1980s under 10 U.S.C.A. § 2354 for research and development contracts.

U.S. Environmental Protection Agency

EPA has used the indemnification authority provided in CERCLA § 119. This section has two key provisions. First, it exempts RACs (environmental restoration contractors who work on NPL sites or conduct removal actions) from the federal strict liability standard to which parties responsible for contaminating the site are held. Instead, these contractors are held liable for cleanup costs only if they are found to be negligent, grossly negligent, or engaged in intentional misconduct. This provision is non-discretionary and applies to all RACs (including DoD RACs) regardless of whether or not indemnification is offered. Second, this section effectively provides EPA with discretionary authority to indemnify RACs against third-party suits for negligence in conducting response action activities at NPL sites and removal action sites.[1] Prior to January 1993, EPA provided RACs with blanket indemnification for third-party liabilities as a result of negligence with no time or dollar limit. Gross negligence, intentional misconduct, and strict liability actions under state law were not covered.

Chapter 5: Indemnification Practices

On 25 January 1993, EPA published final guidelines in the Federal Register for implementing CERCLA § 119. These guidelines state that in future solicitations, EPA will not offer indemnification to RACs. If the solicitation results in an insufficient number of qualified responses and that result can be traced to the lack of indemnification, EPA may issue a new solicitation that includes limited indemnification. The new indemnification provisions must have limits and deductibles that are linked on a sliding scale, with the maximum limit for most contractors set at $50 million. Also, the term of coverage must be limited to the period of contract performance plus ten years. To obtain this indemnification, contractors must demonstrate that diligent efforts were made to obtain insurance, and that insurance was unobtainable at a reasonable price. For existing contracts, EPA and its contractors must renegotiate the indemnification terms to be consistent with the new guidelines.

EPA has paid or is paying on five claims against indemnified environmental restoration contractors. Two of these are pre-SARA[2] claims that together cost EPA about $285,000, primarily for legal fees. The remaining three claims are ongoing. EPA has paid less than $100,000 to date (all for legal fees) on these claims.

Department of Energy

DoE does not generally provide indemnification to its environmental restoration contractors, except to the extent that Price-Anderson coverage is required for nuclear activities. However, DoE often includes a form of risk-sharing called the "accountability rule"[3] in its contracts. DoE has also incorporated the accountability rule in the contract for its environmental restoration management contractor at its Fernald facility. Under the accountability rule, contractors are reimbursed for allowable costs, but they are liable for certain other costs, called avoidable costs (e.g., costs resulting from negligence or willful misconduct), up to a cap. The cap is equal to an amount calculated from what the contractor earns in award fees and other fees for the applicable six-month period. If the avoidable costs exceed this cap, the government is responsible for the balance. The amount of liability incurred by the government is limited by the availability of appropriated funds and by the contract's expenditure cap, if any.

For nuclear activities, DoE provides indemnification as required by the Price-Anderson act. Under this act, the government's liability is limited to about $7 billion.

Department of the Interior

DoI does not generally provide indemnification for environmental restoration contractors.

National Aeronautics and Space Administration

As with the other federal agencies, NASA does not generally provide indemnification for its environmental restoration contractors.

Department of Transportation (Coast Guard)

The Coast Guard's Environmental Compliance and Restoration Authorization[4] requires the Coast Guard to indemnify RACs (as defined in CERCLA) "to the extent that adequate insurance is not generally available at a fair price at the time the contractor enters into the contract to cover the contractor's reasonable, potential, long-term liability." This indemnification uses the authority granted in CERCLA § 119 and applies to contractors working on NPL sites and removal action sites.

The Oil Pollution Act of 1990 (Pub. L. 101-380) requires that the Coast Guard indemnify environmental restoration contractors working at sites that were created by non-federal parties, but for which the Coast Guard has cleanup responsibility. [5]

STATE AGENCIES

As expected, there is no consistent state approach for environmental restoration contractor indemnification. As of April 1992,[6] ten states had statutory authority to offer indemnification to state environmental restoration contractors, although only eight of these states have ever offered it. No claims have been filed against contractors indemnified by these eight states.

Interestingly, 14 states have chosen to provide environmental restoration contractors with immunity rather than indemnification. Immunity means the environmental restoration contractor cannot be sued for injuries or damages resulting from its restoration activities. In these cases, the environmental restoration

contractor is protected and the state does not incur additional liability. However, the public cost is that an injured party may have no way to recover damages.

Sixteen states do not offer either indemnification or immunity to the environmental restoration contractors, rather they require the environmental restoration contractors to indemnify the state against liability resulting from the contractor's activities. An additional 17 states require contractors to indemnify the state, but also offer indemnification or provide immunity to the contractors, viewing their actions as reciprocal indemnification. The effect of this reciprocal indemnification is that each party is responsible for its own actions.

There are 41 states with statutes that probably prohibit indemnification of construction, design, and environmental restoration contractors under certain conditions.[7] These statutes vary widely in their scope and coverage. They were passed to ensure competent construction and design work by prohibiting companies from contracting away liability for their mistakes. It is unlikely that these statutes would affect federal indemnification of contractors since federal contracting is controlled by federal law.

No correlation was found between state indemnification and the number of contractors responding to solicitations. The geographic location and the budget for the work were the most significant factors influencing the number of responses to solicitations. Almost all states could obtain environmental restoration contractors despite not offering indemnification. The states also have not observed a decrease in the available pool of contractors, an increase in the cost of their services, or a delay in cleanups as a result of not offering indemnification.

New Jersey has had a noteworthy indemnification program, partly because it has had two indemnification statutes. The first one was established in 1986 and expired in 1990. Under this statute, the state gave preferential treatment to environmental restoration contractors that obtained pollution liability insurance and did not request indemnification. In 1992, the current indemnification statute was passed. It allows preferential treatment to be given to contractors who provide occurrence-based insurance coverage in lieu of indemnification. To date, no contractor has been able to obtain occurrence-based insurance.[8] The new program also includes a deductible equal to 30 percent of the contract amount, not to exceed $1.5 million, and a co-payment equal to 10 percent of the total claim, in excess of the deductible, not to exceed the indemnification limit specified within the agreement. The state has authority to offer indemnification and legal defense for claims of up to $25 million for a single occurrence and up to $50 million per contract.

New Jersey has never used the new indemnification authority. They did not see any decrease in competition after the original authority to indemnify contractors expired, so they have not felt the need to use the current indemnification statute. For example, New Jersey recently received 5 responses to a solicitation without indemnification for a remedial design for a Superfund site. This level of competition is comparable to what they would have expected when they did offer indemnification. New Jersey also issued a level-of-effort type solicitation for remedial design on unnamed sites. They wondered if they would obtain adequate competition since the respondents had no site information upon which to judge their liability exposure. New Jersey received 16 responses, so they concluded that lack of indemnification was not a significant factor in competition. They did note that there are some firms who bid when indemnification was offered, but who do not bid now. These firms claim that part of the reason for their changed bidding practice is the lack of indemnification. However, New Jersey has not found the omission of these firms to be a hindrance to adequate competition.

PRIVATE ENTITIES

There appears to be a wide variety of indemnification practices in the private sector. There is anecdotal evidence suggesting that some private parties indemnify and others do not, but it is difficult to determine which is the predominant practice. For example, in testimony before the Environmental Restoration Panel of the House Committee on Armed Services,[9] the National Constructors Association (NCA) provided several examples of actual language taken from private hazardous waste cleanup contracts entered into by NCA member companies. These examples provide a broad range of indemnification. Some include limits for certain types of claims, while others do not. Some expressly omit coverage of willful misconduct, while others do not. Some require the contractors also to indemnify the private party, while others do not. This indemnification generally protects the private party

from liabilities arising from the contractor's negligent acts. It does not transfer the private party's existing liabilities to the contractor.

To obtain more specific data from the private sector, DoD sent a questionnaire to the top 26 PRPs listed in order of site frequency from the EPA listing dated 31 March 1991. The questionnaire, the list of the firms contacted, and the 17 responses received can be found in Appendix 7. Most of the PRPs have large cleanup programs ($10 million to $200 million annually) and many contractors. Most of the PRPs are also involved in all phases of cleanup, from the study phase to site close-out. No indemnification claims have been filed against any of the PRPs that responded.

The responses indicate that several PRPs include very limited contractor indemnification in their standard terms. This indemnification usually excludes coverage for any contractor negligence or willful misconduct. In other cases, the indemnification clause is even more limited, and provides protection only when the PRP was negligent. Some PRPs do not indemnify contractors under any circumstances. Others do so reluctantly on a case-by-case basis when it is necessary to obtain the contractor they desire. For example, Monsanto states, "In such instances, Monsanto may agree to indemnify the contractor against specific features or happenings, but only by the most limited indemnification provision which can be arranged to satisfy that contractor." Conversely, most PRPs require the contractor to indemnify them. Again, this indemnification protects the PRP from liabilities that arise from the contractor's negligent acts. It does not transfer any of the PRP's existing liabilities to the contractor. In cases where the PRP indemnifies the contractor and the contractor indemnifies the PRP, the reciprocal indemnification makes each party responsible for its own actions.[10]

This data may indicate that there is a general sentiment in the private sector against providing indemnification to environmental restoration contractors, but that it will be provided to a limited degree on a case-by-case basis when needed.

ENDNOTES:

[1] GAO Report, Superfund: Contractors Are Being Too Liberally Indemnified by the Government, GAO/RCED-89-160, page 14, September 1989.

[2] Superfund Amendments and Reauthorization Act of 1986, 42 U.S.C.A. §9601-9671 (West 1983 & Supp. 1993).

[3] 56 Fed. Reg. 5064 (1991).

[4] 14 U.S.C.A. §691(e) (West 1990).

[5] Letter to Brigadier General W. O. Bachus, USA (Ret.) from Rear Admiral P. A. Bunch, U.S. Coast Guard, dated 25 January 1993 (*see* Appendix 4).

[6] State Indemnification Report prepared for EPA, 23 April 1992 (*see* Appendix 1).

[7] Anti-Indemnification Summary, EPA (*see* Appendix 1).

[8] Data collected by DoD indicates that the pollution liability insurance that is currently available covers only claims made during the 1- to 3-year life of the policy ("claims made") rather than claims made at any time in the future, but arising from occurrences during the life of the policy ("occurrence-based"). *See also* Chapter 6.

[9] *Hearing Before the Environmental Restoration Panel of the Committee on Armed Services House of Representatives*, 102 Cong. 3rd Sess. (1992).

[10] DoD's situation is somewhat different from private parties in that DoD is part of the federal government. As such, it is generally immune from suit. Chapter 4 provides a discussion on when the federal government might be subject to suit.

Chapter 6: Insurance

Response to § 332, Paragraph (6)

Paragraph (6): The availability, the coverage, the cost, and the type of insurance commercially available to environmental restoration contractors at current and former military installations and formerly used defense sites.

SYNOPSIS

By the mid-1980s, most of the insurance industry ceased to offer new environmental impairment liability (EIL) insurance policies. However, by the early 1990s, some limited-coverage EIL policies became available with very high premiums. The recent trend in the insurance industry has been to make more insurance available to cleanup contractors than in the past.

Advertised rates remain high, although negotiated rates, particularly for large multi-contract (bulk-rate) policies, are becoming somewhat more reasonable. Policies are still carefully written to limit the insurance company's exposure. Policies covering "long-tail" liabilities—those that occur decades after the policy is written and the premiums paid—are not yet available. (Long-tail coverage is particularly important for environmental restoration contractors because many health effects that may result from an improperly performed environmental cleanup do not emerge for 20 or 30 years.) However, great strides toward providing long-tail coverage have been made on large multi-contract policies by negotiating terms with the insurance companies. It may be that the better terms and lower costs available on multi-contract policies are due more to the increased negotiating power than to the "economies of scale" that typically impact bulk-rate costs.

The availability and terms of EIL insurance are highly dependent on the claims history experienced by the insurance industry. The virtual withdrawal of EIL insurance in the 1980s as a result of increased pollution claims serves as recent evidence of this. If the number of valid claims, or even ones sufficiently arguable to entail significant defense costs, turns out to be high, the availability of insurance could be curtailed from even the somewhat limited amount offered today. Insurance companies have been severely impacted by the emergence of occupational diseases and the enactment of unforeseen environmental legislation. Standard policies written in the 1950s have been held to cover pollution effects and cleanup costs that were not taken into account in calculating premiums for those policies. Insurance companies contesting their liability to cover such costs have been a leading source of hazardous-waste–related litigation costs.[1]

BACKGROUND

Prior to the 1970s, the insurance industry offered comprehensive general liability policies to cover a broad range of commercial liability resulting from accidental personal injury or property damage, usually including pollution incidents. In the late 1960s, the insurance industry added a "pollution exclusion" clause to the standard comprehensive general liability policy. It specified that the policy covered only sudden and accidental pollution incidents. During the 1970s, some insurers developed a specific type of policy, called an EIL policy, to expressly cover pollution risks. However, by the mid-1980s, new policies of this type were not being offered by most insurers.

The decision to discontinue offering EIL policies was primarily due to the insurance industry's concern that new environmental legislation, coupled with trends in common law and court interpretations of environmental law, had broadened the insurance companies' liability beyond what the companies had intended to insure against.[2] In addition, the insurance industry was experiencing an actual increase in the number and dollar value of claims being filed during this period. The RAND Institute for Civil Justice surveyed four national insurance carriers on claims involving hazardous waste cleanup sites. The claim payments per surveyed firm rose from an average of $9 million in 1986 to over $17 million in 1989. The number of pending claims also rose rapidly during this time, from about 650 per firm to 2,200, and the average number of policyholders that filed claims grew from 200 to 1,000.[3]

The RAND survey also found that an average of 88 percent of the insurer outlays through 1992 have been for transaction costs: either the legal costs of coverage disputes or the legal costs to defend the policyholder.[4] That means that only 12 percent of the claim payments have been for actual indemnification: the costs of site cleanups or third-party claims. This is consistent with the small number of final judgments made on litigation involving environmental restoration

contractors (see Chapter 4). The survey found no substantial difference between the transaction-cost shares of insurer outlays paid for NPL sites versus non-NPL sites. In both cases, the transaction-cost shares are much higher than what the insurers typically experience on other lines of property-casualty insurance. (For comparison, comprehensive general liability insurance typically experiences a transaction-cost share of approximately 30 percent.[5])

INSURANCE AVAILABILITY AND COVERAGE

In recent years, specialty underwriters have begun to provide pieces of the necessary insurance coverage for environmental restoration contractors. For example, a version of EIL insurance called Contractors Pollution Liability (CPL) insurance covers liabilities associated with bodily injury, property damage, and environmental cleanup costs for the contractor's described operations. There are also new Architect and Engineers Errors and Omissions (E&O) policies that, in addition to the traditional E&O coverage, cover pollution claims resulting from negligent acts, errors, and omissions arising out of a described professional service. The specialty underwriters have also recently developed a new custom-tailored E&O policy designed to cover firms that perform environmental remediation services. This policy is often no more expensive than traditional E&O coverage without pollution liability coverage.[6]

In addition to describing insurance in terms of the coverage it provides, policies can be further categorized as being on a "claims-made" basis or an "occurrence" basis. A claims-made policy means that the insurance only applies to claims made in the year the policy was in effect. An occurrence-based policy covers all claims that result from incidents that occurred during the policy life, whenever the claims are filed. This is a particularly important distinction in the context of environmental restoration. It is anticipated that many potential health effects such as cancer, that might result from improper environmental restoration, may not appear until decades after the restoration work is completed. Therefore, to cover the highly uncertain "long-tail" liabilities, insurance—or any other risk-sharing mechanism—must be in effect for many years past the end of the contract period.[7]

Currently, no insurance company offers occurrence-based pollution liability insurance of any type. All of the policies now available are of the claims-made type, although some policies are available with so-called "tail coverage" that provides coverage for a set number of years beyond the end of the contract. Therefore, the effective coverage period is generally limited to one year unless tail coverage is available and purchased. In that case, the coverage will extend through the specified tail period. The longest coverage DoD found referenced in the insurance industry literature was for seven years (presumably including the contract period). This was for a specialty package designed for Superfund PRPs to use to cover their contractors.[8] Willis Corroon Environmental Risk Management Services, an environmental insurance broker, states that they have put together contract-specific programs that cover the duration of the contract and provide three to four years of extended discovery.[9] The NCA obtained information from the Marsh MacLennan insurance brokers that indicated that standard "tail coverage" was available for one year at an additional cost equal to the original premium. They further report that at significant additional cost, it might be possible to negotiate a longer term of three to perhaps five years.[10] However, as we will see later, EPA has been able to negotiate longer tail periods at lower costs in specific cases.

COST OF INSURANCE

Insurance costs and terms are highly dependent on the specifics of the work to be covered. However, Willis Corroon reports that over $50 million of coverage[11] is available for both CPL- and E&O-type contracts on a claims-made basis.[12] (It is interesting to note that the insurance comparison tables attached to the letter reporting this information do not support this contention. The largest coverage listed in the comparison tables is a $30 million professional E&O liability insurance policy, provided by London underwriters, that does not cover strict liability. With the exception of this policy, the highest coverage listed in the tables is $10 million per claim and $20 million aggregate.[13]) Willis Corroon also reports that pricing for the first $1 million to $6 million in coverage will be about 2 percent of yearly revenues for small contracts ($1 million to 2 million in revenue) to less than 1 percent for large contracts. Willis Corroon does not provide any pricing information for higher coverage.

Most policies cover only negligence and do not cover strict liability. However, there are a few policies

that cover both negligence and strict liability and also have a $10 million limit. Pricing information is not available for these policies.

More recent information indicates that it might be possible to negotiate better terms and conditions from the insurance industry than are generally advertised. For example, EPA has approved the purchase of about 50 insurance policies for its contractors. Most of those are less than $5 million policies with no tail coverage. A few policies are for higher amounts, and some include tail coverage. These are of two types: per-contract policies and multi-contract (bulk-rate) policies. The per-contract policies generally have less coverage (lower maximums, higher deductibles, shorter tail coverage) and higher costs (as a percentage of total contract cost) than the bulk-rate policies. For example, a $10 million per-contract policy with a $250,000 deductible and no tail coverage costs about 2.25 percent of the contract cost. A $10 million bulk-rate policy[14] to cover a 3-year contract and 10-year tail period with a $100,000 deductible costs between 1.5 percent and 2 percent of the contract cost. In a similar comparison, a $25 million per-contract policy (the highest per-contract coverage on EPA's list) with a $100,000 deductible to cover a 2-year construction period and a 5-year tail period costs almost 5 percent of the contract cost. A $30 million bulk-rate policy with a $100,000 deductible to cover a 3-year contract and a 10-year tail period is available for between 2 percent and 2.5 percent of the contract cost.[15]

ENDNOTES:

[1] *Superfund and Transaction Costs: The Experiences of Insurers and Very Large Industrial Firms*, Jan Paul Acton, Lloyd S. Dixon, RAND Institute for Civil Justice, 1992. ISBN: 0-8330-1239-8.

[2] GAO Report, *Hazardous Waste: Pollution Claims Experience of Property/Casualty Insurers*, GAO/RCED-91-59, 5 February 1991 (*see* Appendix 6).

[3] *Superfund and Transaction Costs: The Experiences of Insurers and Very Large Industrial Firms*, Jan Paul Acton, Lloyd S. Dixon, RAND Institute for Civil Justice, 1992. ISBN: 0-8330-1239-8.

[4] Some firms spent a high proportion on coverage disputes, while others spent a high proportion on legal costs to defend the policyholder.

[5] *Superfund and Transaction Costs: The Experiences of Insurers and Very Large Industrial Firms*, Jan Paul Acton, Lloyd S. Dixon, RAND Institute for Civil Justice, 1992. ISBN: 0-8330-1239-8.

[6] *Managing Contractors Environmental Liability: Risk Financing Considerations*, David J. Dybdahl, Willis Corroon, undated (*see* Appendix 5).

[7] Of the claims analyzed in the RAND survey, 78 percent were for cleanup costs only. Only 16 percent involved bodily injury or property damage, sometimes in conjunction with cleanup costs as well. This is not unexpected if it is true that third-party liabilities are more likely to be incurred during cleanup since this phase of site remediation is just beginning.

[8] *Superfund Site PRP-Controlled Pollution Liability Insurance Program*, Willis Corroon Environmental Risk Management Services, undated (*see* Appendix 5).

[9] Letter to Vic Wieszek, DoD, from Kenneth W. Ayers, Willis Corroon Environmental Risk Management Services, dated 31 January 1993 (*see* Appendix 5).

[10] Attachment B of Letter to Patrick Meehan, DoD, from Robert P. McCormick, National Constructors Association, dated 3 February 1993 (*see* Appendix 5).

ENDNOTES (Continued):

[11] The insurance industry has expressed concerns that catastrophic failures resulting in extensive damage to human health and the environment could easily result in claims surpassing $100 million per incident. *See Environmental Protection Agency Indemnification for Response Action Contractors*, Kenneth W. Ayers, Willis Corroon Environmental Risk Management Services, undated (*see* Appendix 5).

[12] Letter to Vic Wieszek, DoD, from Kenneth W. Ayers, Willis Corroon Environmental Risk Management Services, dated 31 January 1993 (*see* Appendix 5).

[13] The Hazardous Waste Action Coalition Professional Liability Pollution Insurance Survey, dated 1 April 1992 (*see* Appendix 5), and the Environmental Impairment Liability Market Survey by Johnson & Higgins, dated March 1992 (*see* Appendix 4), also show the maximum limit to be $10 million per claim.

[14] These costs are reported on a per contract, but are based on covering four large, multi-year, cost-reimbursement contracts.

[15] This analysis is based on proprietary data from EPA files.

Chapter 7: DoD Indemnification

Response to § 332, Paragraph (7)

Paragraph (7): The extent to which the Secretary of Defense and the Secretaries of the military departments have used existing indemnification authority for environmental restoration work.

SYNOPSIS

DoD has not used the existing indemnification authorities described in Chapter 2 to cover environmental restoration work.

INTRODUCTION

As Mr. Thomas Baca (former Deputy Assistant Secretary of Defense [Environment]) stated in his testimony to Congress,[1] "the Department of Defense has not generally indemnified its contractors. The Department of Defense has not authorized indemnification for any contractor performing under its environmental restoration program." The specific indemnification authorities provided by Pub. L. 85-804, 10 U.S.C. § 2354, and CERCLA § 119 have not been used for indemnification of environmental restoration contractors working on DoD installations.

More recently (January 1993), The Society of American Military Engineers reported on a poll that included the Engineer Service Chiefs from the Army, Navy, and Air Force.[2] The Army and the Navy report that there have been no approved or pending uses of Pub. L. 85-804, 10 U.S.C. § 2354, or CERCLA § 119 indemnification authorities to indemnify environmental restoration contractors to date. In a separate memorandum, the Air Force reported the same position.[3]

ENDNOTES:

[1] *Department of Defense Remedial Action Contractor Liability and Indemnification: Hearing Before the Environmental Restoration Panel of the House Committee on Armed Services*, 102 Cong., 2d Sess. 1 (1992).

[2] *See* letter and attachment from W. O. Bachus, Executive Director, The Society of American Military Engineers, to Mr. Patrick Meehan, Acting Assistant Secretary of Defense (Environment), dated 28 January 1993 (*see* Appendix 4).

[3] Memorandum for Deputy Under Secretary (Environmental Security) from Gary Vest, Deputy Assistant Secretary of the Air Force (Environment, Safety, and Occupational Health), 6 May 1993 (*see* Appendix 2).

Chapter 8: Costs of New Authority

Response to § 332, Paragraph (8)

Paragraph (8): The potential costs of any new indemnification authority, if any, recommended by the Secretary of Defense in the report required under this section.

SYNOPSIS

This report does not recommend any additional indemnification authority at this time. However, DoD will continue to monitor the situation to ensure that DoD environmental restoration work is performed in an efficient and cost-effective manner. Therefore, rather than discuss the costs of any new indemnification authority, this response discusses possible costs and benefits of various indemnification policies.

If the government indemnifies an environmental restoration contractor, it in effect becomes the insurance company for the liabilities the contractor is indemnified against. In the simplest case, the government saves the cost of insurance, but increases its potential future outlays for claims against the contractor. Under ideal conditions, there will be no difference in cost to the government for indemnifying contractors rather than purchasing insurance for them.

However, it is clear that ideal conditions do not exist. Most notably, current insurance policies do not provide the long-tail coverage that indemnification could provide (*see* Chapter 6). Therefore, indemnification would cover more claims than insurance would, and may cost the government—and ultimately the individual taxpayer—more in out-of-pocket expenses than if the government had simply reimbursed the contractor for insurance.[1]

This potential additional cost must be balanced against the important, but difficult to quantify, social cost that exists if the government relies solely on the somewhat limited insurance coverage currently available and does not indemnify its environmental restoration contractors. This social cost results from the fact that an injured party may have no way to recover damages if insurance does not cover the claim, the contractor has insufficient assets to pay, and the government has not provided indemnification.

Since the government would probably be liable along with the environmental restoration contractor for cleanup costs under CERCLA, indemnifying the contractor for this type of liability might cost the government only moderate additional amounts. However, indemnifying the contractor for third-party claims could potentially cost the government much more. This is because the government would otherwise be immune from state law-based tort claims based on strict liability and have the discretionary function defense available against some negligence claims, leaving the contractor to shoulder such third-party claims itself (*see* Chapter 4).

Most legal costs are passed through to the government through various mechanisms, regardless of indemnification. Therefore, there may not be much difference in legal costs paid by the government whether indemnification is provided or not.

Environmental restoration contractors who perform work without indemnification may avoid innovative technologies because, by definition, the success of these technologies is less certain. Consequently, the use of innovative technologies may incur a higher risk of liabilities. However, it is very difficult to estimate the cost to the government that results from this avoidance of innovative technologies that are potentially more efficient and cost-effective.

Environmental restoration contractors contend that offering indemnification to them might widen the field of bidders and proposers, improving the chances that DoD would obtain the best environmental restoration value possible. However, there is no clear evidence to suggest that DoD is not currently obtaining sufficient competition to ensure the best value. In fact, limited evidence from EPA and the state of New Jersey, both of whom routinely offered indemnification in the past but no longer do so, suggests that there is no noticeable effect on the level of competition resulting from a lack of indemnification. (Chapter 3 provides additional information on the adequacy of competition question.)

APPROACH

This report does not recommend any additional indemnification authorities at this time. It is not yet clear whether DoD's future needs for environmental contractors will best be met without using any of the existing indemnification authorities available to it (as is its current practice), by applying these existing authorities in some future contracts, or through some

new authority. Nonetheless, it is apparent that there are both costs and benefits to using, or not using, indemnification authorities on environmental restoration contracts, though they cannot be quantified at the present time. This response will outline some of the ways that indemnification, or the lack of it, might influence the cost of environmental restoration work in DoD.

INDEMNIFICATION SUBSTITUTED FOR INSURANCE

When the government indemnifies an environmental restoration contractor, it in effect becomes the insurance company for the liabilities the contractor is indemnified against. Stated simply, the government can either (1) reimburse the contractor for the purchase of insurance to cover the liabilities, thereby transferring the risk to the insurance company, (2) indemnify the contractor for the liabilities, thereby transferring the risk to the government, or (3) do neither, effectively transferring the risk to the public to the extent that the contractor lacks the assets to pay a claim.

There is no cost difference to the government between options 1 and 2 if certain ideal conditions are met: the insurance must be priced so that the premiums cover the claims paid by the insurance, the administrative costs, and insurance company's profit; the government's cost of administering the indemnification must equal the insurance company's administrative costs and profit; and most importantly, the insurance coverage must be equivalent to the indemnification coverage. However, it is unlikely that these ideal conditions would hold true. Because of the lack of a claims history, insurance companies are unsure of the proper premium to charge, as evidenced by the rapidly changing premiums, terms, and conditions available (*see* Chapter 6). It is unknown if the government can administer an indemnification program in such a way that the administrative costs are equal to the insurance industry's administrative costs and (unknown) profit. Most importantly, it is clear that currently available insurance does not cover the "long-tail" liabilities—those liabilities that result from claims made decades after the environmental restoration work has been completed and the premiums paid—whereas indemnification would presumably be structured to cover these liabilities. Therefore, since indemnification would cover more claims than would insurance, it is possible that indemnification (covering long-tail liabilities) would cost the government more than simply purchasing conventionally-available insurance (which does not cover long-tail liabilities).

Looking at it another way, if the government's objective was to provide protection for the contractor against long-tail liabilities, indemnification is probably more cost-effective than insurance. This is because the only way to cover long-tail liabilities with insurance (if it is possible at all) would be to purchase claims-made insurance year after year. Claims-made insurance is very expensive, so it is likely that indemnification would be less expensive.

Of course, a middle course exists as well. As discussed in Chapter 1, the government could provide limited indemnification, with deductibles and maximums, that would still provide greater protection than is currently available through insurance. In theory, this indemnification could be structured so that its cost would equal the cost of insurance currently available, but provide broader coverage. In addition, because of its deductible and maximum terms, it would have the added benefit of providing incentives for the contractor to maintain a high standard of performance.

INSURANCE COSTS WITHOUT INDEMNIFICATION

When indemnification is not offered, concerned contractors tend to purchase insurance even if its coverage is not as much as they would want. This is especially true for cost-reimbursement contracts, where the cost of insurance is generally an allowable cost. With insurance becoming more widely available and with better coverage, the cost to the government can be substantial. Therefore, this insurance cost must be recognized as a cost associated with the policy of not providing indemnification.

SOCIAL COSTS

There is an often overlooked social cost associated with the policy of not providing indemnification to environmental restoration contractors. Who pays for the losses and injuries of citizens exposed to a release from a DoD site if the government need not compensate them and the contractor lacks insurance and the financial resources to do so? As discussed above and in Chapter 6, currently available insurance is not likely to cover all potential claims, particularly the all-important "long-tail" claims. Also, as discussed in Chapter 3, there is

evidence that most environmental restoration contractors do not have sufficient financial resources to withstand a substantial claim without insurance or indemnification. This results in the very real possibility that injured parties have no mechanism to obtain compensation for damages resulting from the cleanup of a DoD site if the government does not provide indemnification. In fact, this situation exists on a smaller scale at state-run cleanups in the 14 states that have provided immunity, rather than indemnification or insurance, for their environmental restoration contractors (*see* Chapter 5.)

The Army notes a situation where some type of indemnification may have been appropriate because of social cost aspects, but which was not clearly covered under existing indemnification authorities.[2] In January 1993, construction crews working in the Spring Valley neighborhood of Washington, DC, unearthed 141 intact chemical munitions dating from World War I. This led to the discovery that this residential area had once been a testing ground for chemical warfare. The 141 munitions were removed under a CERCLA removal action. The Army is now continuing its remedial activities throughout the area to determine if additional munitions remain in the area.[3] The contractor hired by the Army may be conducting intrusive testing on individual homeowners' lots throughout the Spring Valley area. The homeowners have expressed great concern about their ability to recover damages from the United States in the event of contractor negligence. Since the formerly used defense site is not on the NPL, indemnification was not possible through CERCLA § 119. Army officials also concluded that significant uncertainty regarding the applicability of Pub. L. 85-804 to a FUDS cleanup and the administrative process required for Pub. L. 85-804 approval, made that authority unavailable. Therefore, the Army opted to reimburse the contractor for costly insurance. Army attorneys report that had clear indemnification authority been available, its use would have been recommended.

COST OF CLEANUP

Relieving the contractor from strict liability on government cleanups would obligate the government to pay for cleanup work that became necessary because of the contractor's non-negligent action. Because of CERCLA § 119's statutory waiver of strict liability for cleanup costs for these contractors, this obligation is effectively in place for environmental restoration contractors performing work at NPL sites or performing removal actions. However, strict liability for cleanup costs remains in effect for most of the DoD environmental restoration contractors since they perform remediation at non-NPL sites, and therefore do not qualify for the CERCLA § 119 waiver (*see* Chapter 2). These contractors are currently liable for cleanup costs that may result even though they perform satisfactorily or even perfectly.

Relieving additional contractors from strict liability under CERCLA would require the government to pay for cleanup costs resulting from the contractor's non-negligent actions that, in the absence of this waiver, the contractor might at least have to share. On the other hand, the government as site owner will normally have joint and several liability, and thus may have to pay for the cleanup costs regardless of the possibility that the contractor might also be liable. This will be particularly true if the contractor is uninsured or has inadequate assets to pay the claim.

Indemnifying environmental restoration contractors against cleanup costs resulting from negligent acts would increase the cost exposure of the government. Responsibility for negligent acts is easier for courts to divide, so joint and several liability is less certain, particularly given the recent Appeals Court decisions on the limited applicability of joint and several liability to CERCLA cleanup costs (*see* Chapter 4). Therefore, where the contractor is at fault, the government might avoid cleanup liability altogether despite owning the site. Of course, a government agency could avoid legal liability, but then it could be compelled by Congress to pay anyway. Thus the actual cost impacts of protecting contractors from CERCLA cleanup liability are very fact-dependent.

COST OF THIRD-PARTY CLAIMS

The potential cost impacts of assuming the contractor's tort liability to third parties are somewhat different. Tort claims (actions for damages to property or personal injury) introduce a series of governmental immunities that would frequently shield the government from suit even though it would have been liable if it was a private party. This might leave the environmental restoration contractor as the sole remaining defendant. If the government indemnified the contractor, the increased cost in a particular case could be substantial.

The most important of the governmental immunities to tort suits for the purposes of this report are the strict-liability exception and the discretionary-function exception. Suits against the government must be based on negligence or fault, not on strict liability. (The government is liable for CERCLA cleanup costs without fault, but only because Congress chose to write CERCLA that way.) The "discretionary function" exception provides that the government is immune from suit when the action in question arises from the exercise of a discretionary function—making a choice. Courts have divided sharply over the meaning of this term, but it seems that the choice must be based on "considerations of social, economic, or political policy."[4] (*See* Chapter 4 for a more detailed discussion of the strict liability and discretionary exceptions.) Taken together, these two exceptions mean that (1) when the government, as site owner, and the contractor are both strictly liable for damages or injuries, the contractor is the only party subject to a judgment, and (2) when the government and the contractor are both liable for a negligent act, but the government is exercising a discretionary function, again the government is immune, and the contractor is the only liable party. Providing indemnification under either circumstance means that the government would be paying a judgment it could otherwise avoid. It is difficult to determine, or even guess at, the number of occasions in which these circumstances could arise. Contractors are apparently deeply concerned about them, but it is not clear that they are common.

LEGAL COSTS

The contractor's cost of legal counsel to defend against environmental and third-party claims deriving from environmental work can be onerous. In various ways, many of these costs are paid by the government today as allowable costs or overhead. On firm fixed price contracts, the overhead cost of legal defense, if any, is buried in the bid. There is no data to show how much this is. Some forms of indemnification would eliminate the need for these costs at the contractor's level because the government would provide the defense, generally at lower cost than the private bar. In many cases, however, the contractor and the government would have sufficiently different interests that both would be represented by counsel, with the government paying for all of them. Since some legal defense costs are already being paid, directly or indirectly, any saving from indemnification is speculative.

INNOVATIVE TECHNOLOGY

Innovative technology in the environmental restoration field is expected to help reduce costs and accelerate cleanup. Substantial uncertainty surrounds innovative technology since by definition, environmental restoration contractors have acquired only limited experience with it. The risk of liability associated with using new technology might be substantial, since in many instances it could be considered developmental. Insurance for use of innovative technology is expected to be even more difficult to obtain than for conventional approaches, but no data has been developed to demonstrate this assertion. Similarly, there is no data at present showing that the lack of indemnification is inhibiting introduction of new technology in DoD cleanups or affecting its cost.[5]

INADEQUATE COMPETITION

Indemnification might widen the field of bidders and proposers on DoD environmental restoration contracts and improve the likelihood that the most technically qualified contractors would work on DoD's behalf at the best possible price. The value of having the most experienced and capable contractors is obvious in principle, but very difficult to evaluate in terms of economics or quality. It is not clear that the present field of bidders represents other than the best qualified ones for the work they seek to do. There are unsubstantiated assertions that there are better ones who will not bid because of lack of indemnification. Some of these assertions date from the time when EPA offered indemnification and other federal agencies, including DoD, did not; some are current. Most federal agencies currently offer cleanup contracts without indemnification, so contractors essentially must choose to do government work without indemnification or look elsewhere. As DERP moves further into the RD/RA phase, it may become apparent that there is a problem that only indemnification can solve. Hard evidence for that proposition has yet to emerge.

ENDNOTES:

[1]Note that if the government reimbursed contractors for "claims-made" insurance year after year so that the insurance coverage was equal to the indemnification coverage, the insurance cost would probably be much higher than the indemnification cost.

[2]Memorandum for Deputy Under Secretary of Defense for Environment, from William McGowan, Office of Judge Advocate General, 5 May 1993 (*see* Appendix 1).

[3]In October 1993, an additional munition was found in the area, lying on top of the ground. This prompted the Army to accelerate its investigation of the area.

[4]*U.S. v. Gaubert*, 499 U.S. 315 (1991).

[5]There is evidence that innovative technologies are being selected more often as remedies at NPL sites. In 1987, innovative technologies were selected at about 5 NPL sites. In 1991, innovative technologies were selected at over 55 NPL sites. This data does not provide information on the adequacy of competition for designing, installing, or operating the innovative technologies. It also does not indicate whether indemnification was offered, and whether such an offer affected the selection of innovative technologies. *See Cleaning Up the Nation's Waste Sites; Markets and Technology Trends*, EPA 542-R-92-012, April 1993.